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THE CONCEPT OF INTERNAL CONTROL IN FOREIGN PRACTICE

One of the main objectives of economics in market conditions is a comprehensive mastering the system of economic management, important function of which is internal control.

In the current economic conditions it is difficult to imagine the company manager (investor or owner) who deprives himself of an opportunity to receive regularly or occasionally complete, truthful and impartial information about the financial condition, assets, expenses and results of operations. Such information can be obtained through clearly arranged internal control exercised in the implementation of management decisions.

Internal control or internal control system is the integration of the activities, plans, attitudes, policies, and efforts of the people of an organization working together to provide reasonable assurance that the organization will achieve its objectives and mission.

At the organizational level, internal control objectives relate to the reliability of financial reporting, timely feedback on the achievement of operational or strategic goals, and compliance with laws and regulations. At the specific transaction level, internal control refers to the actions taken to achieve a specific objective (e.g., how to ensure the organization's payments to third parties rendered for valid services.) Internal control procedures reduce process variation, leading to more predictable outcomes.

There are many definitions of internal control, as it affects the various constituencies (stockholders) of an organization in various ways and at different levels of aggregation.

Discrete control procedures, or controls are defined by the SEC as: "...a specific set of policies, procedures, and activities designed to meet an objective".

The Committee of Sponsoring Organizations of the Treadway Commission (COSO) developed a model of internal controls, promulgated it among members of the various stockholder organizations and, in 1992, published what now is referred to as the COSO Model of Internal Control.

COSO defines internal controls as "a process, effected by an entity’s board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in (1) the effectiveness and efficiency of operations, (2) the reliability of financial reporting and (3) the compliance of applicable laws and regulations".

The first category addresses an entity's basic business objectives, including performance and profitability goals and safeguarding of resources. The second relates to the preparation of reliable published financial statements, including interim and condensed financial statements and selected financial data derived from such statements, such as earnings releases, reported publicly. The third deals with complying with those laws and regulations to which the entity is subject. These distinct but overlapping categories address different needs and allow a directed focus to meet the separate needs.

This definition emphasizes that internal control is:

- a process consisting of ongoing tasks and activities. It is a means to an end, not an end in itself;
- effected by people. It is not merely policy manuals, systems and forms, but about people at every level of an organization that impact internal control;
- able to provide only reasonable assurance, not absolute assurance, to an entity's senior management and board;
- geared to the achievement of objectives in one or more separate but overlapping categories;
- adaptable to the entity structure.

The COSO definition relates to the aggregate control system of the organization, which is composed of many individual control procedures.

According to the COSO Framework, everyone in an organization has responsibility for internal control to some extent. Virtually all employees produce information used in the internal control system or take other actions needed to affect control. Also, all personnel should be responsible for communicating upward problems in operations, noncompliance with the code of conduct, or other policy violations or illegal actions.

The COSO Model of Internal Controls uses five elements of internal controls: control environment, risk assessment, information and communication, control activities, and monitoring. Description of each components is provided below.

*Control environment.*The control environment is the set of standards, processes, and structures that provide the basis for carrying out internal control across the organization. It is a foundation for all other components of internal control, providing discipline and structure. Control environment factors include the integrity, ethical values and competence of the entity's people; management's philosophy and operating style; the way management assigns authority and responsibility and organizes and develops its people; and the attention and direction provided by the board of directors.

Risk Assessment. Every entity faces a variety of risks from external and internal sources that must be assessed. A precondition to risk assessment is establishment of objectives, linked at different levels and internally consistent. Risk assessment is the identification and analysis of relevant risks to achievement of the objectives, forming a basis for determining how the risks should be managed. Because economic, industry, regulatory and operating conditions will continue to change, mechanisms are needed to identify and deal with the special risks associated with change.

Control activities. Control activities are the actions established through policies and procedures that help ensure that management’s directives to mitigate risks to the achievement of objectives are carried out. Control activities are performed at all levels of the entity, at various stages within business processes, and over the technology environment. They may be preventive or detective in nature and may encompass a range of manual and automated activities such as authorizations and approvals, verifications, reconciliations, and business performance reviews. Segregation of duties is typically built into the selection and development of control activities. Where segregation of duties is not practical, management selects and develops alternative control activities.

Information and communication. Information is necessary for the entity to carry out internal control responsibilities to support the achievement of its objectives. Management obtains or generates and uses relevant and quality information from both internal and external sources to support the functioning of other components of internal control. Communication is the continual, iterative process of providing, sharing, and obtaining necessary information. Internal communication is the means by which information is disseminated throughout the organization, flowing up, down, and across the entity.

Monitoring Activities. Internal control systems need to be monitored – a process that assesses the quality of the system's performance over time. This is accomplished through ongoing monitoring activities, separate evaluations or a combination of the two. Ongoing monitoring occurs in the course of operations. It includes regular management and supervisory activities, and other actions personnel take in performing their duties. The scope and frequency of separate evaluations will depend primarily on an assessment of risks and the effectiveness of ongoing monitoring procedures. Internal control deficiencies should be reported upstream, with serious matters reported to top management and the board.

As a conclusion, it can be noted that internal control can provide reasonable, not absolute, assurance that the objectives of an organization will be met. The concept of reasonable assurance implies a high degree of assurance, constrained by the costs and benefits of establishing incremental control procedures.

There are no uniform regulations (recommendations) how to develop, implement and determine the effectiveness of the internal control system in the company in domestic practice. Experience of foreign countries can be an example for Ukrainian companies. At the same time, we can’t replicate all the provisions of foreign practice, because in every country economic activity of entities has its own characteristics that can’t be ignored.