PERSPECTIVES OF INTERNAL CONTROL SYSTEM

BY

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Abstract

This paper which looked at the concept of internal control including its classification into financial and administrative forms, was anchored on the agency theory. The problem of the study was inability of management to identify indicators of weak internal control system in organizations. The objectives of the paper were to (1) discuss elements of internal control system and (2) identify indicators of weak internal control in organizations. Descriptive methodology was utilized. Basic tests to determine whether reliance should be placed on internal control during auditing were also examined. The paper concluded that a strong internal control system is a necessary condition, among others, for organizational growth.

INTRODUCTION

One of the major indices of organizational growth is return on capital employed (ROCE). While management of corporate organizations look unto it (ROCE) as a measure of their managerial ingenuity, shareholders see it as a definition of their investment objective. Even, financial analysts view increasing ROCE as a good and reliable sign of corporate viability.

Sometimes, managerial efforts towards enhancing organizational growth could be vitiated by leakages in internal control system. It may be necessary to state that some leakage points may be easily detectable while others are not. Put differently , while some lapses in internal control may result in immediate pecuniary loss, others may take a relatively long time before their impacts on organizational growth which may or may not be pecuniary would become noticeable. The nature of effects of lapses in internal control happens to be one of the bases for its (internal control) classification into financial or administrative.

THEORETICAL FRAMEWORK

This work is anchored on the agency theory. An agency relationship exists whenever one or more individuals, called principals, hire one or more individuals, called agents to perform some service and then delegate decision-making authority to the agents. The primary agency relationships in business include those between;

(a) Shareholders and managers

(b) Debtholders and shareholders (Eisenhardt, 1989).

However, we shall concentrate on the relationship between shareholders and managers here. Once managers are appointed, shareholders expect them to take all necessary actions that will maximize their (shareholders) wealth including protecting and safe-guarding the assets of the organization. In practice, the relationship is not always harmonious, thus giving rising to agency conflicts or conflicts of interest between agents and principals. This manifests in managers seeking to maximize their own utility at the expense of corporate shareholders (Shankman, 1999).

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