

ORIGINAL CONTRIBUTION

Approaches to the Detection of Internal Control and Audit

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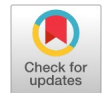
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Abstract— The purpose of this research is to define approaches and control measures to the internal control and audit system in the economic entity, which is a key function of internal audit. The urgency of the research topic is driven by the need to improve the control system, which is one of the important factors for countries in transition economies. The methodological basis of the research was provided by the papers of Georgian and foreign scientists dedicated to the internal control of the corporation and specifically to the internal audit. The methodological basis of the research has become the dialectical method of studying economic events and processes. In addition, general and specific scientific methods of knowledge of events and facts were used. This study developed a set of documentation for performing control procedures that will reduce the time required for calculations and increase object verification accuracy. This study provides insights for scholars and practitioners and encourages them to systematically analyze the audit and its development directions.

Index Terms— Internal Audit, Internal Control, Control Procedures, Functional Approach.

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Introduction

The purpose of this paper is to find ways of improving the control methodology by introducing an objective assessment of the financial condition of the enterprise and intensifying the control directly related to the proper operation of the institution.

Companies may have different organizational forms of internal control and audit (Chang et al., 2019; Chalmers et al., 2019). Decisions on the control bodies and its forms, in particular the internal audit service, are taken by the owners or the superior executive of the company provided that the owners have delegated the relevant authorities. The following factors are taken into consideration when making decisions: Division of ownership and management functions; Dimensions and structural divisions; Risk level, which is constantly present during company activities; Maturity of the control environment.

The corporation as an organizational form is an enormously productive social invention. Partly because of its success it is under increasing attack from various quarters, often under the guise of “protecting” investors from self-interested managers. Some of these attacks are successful simply because the corporation is a poorly understood entity (Lynch, 2006). The urgency of the research topic is driven by the need to improve the control system, which is one of the important factors for countries in transition economies.

Literature Review

In the work is used the works of foreign and Georgian scientists. Historically the first, which explains corporate relations, is the concept of Agency Theory; its founders are American economists (Jensen & Meckling, 1979). According to the agency theory, managers are agent-workers hired by owners who act in such a way as to maximize owners’ interests’ priority.

In accordance with the managerial concept, top managers are in the role of leaders that have delegated powers, rights and responsibilities (that is, increasing their status) which can submit the requirements to any contractor and person who must act on behalf of others. For this purpose, it is necessary to improve the legislative and legal framework and the internal regulatory documentation of the company, which should help the parties of corporate relations to fulfill their duties honestly to each other.

The concept of social responsibilities focuses on business responsibilities to society (Agudelo et al., 2019). Accordingly, all parties of corporate relations, from employees of corporation, other stakeholders, contractors and consumers, and those who live in nearby settlement areas, states and territories, are involved in the corporate governance system (Nave & Ferreira, 2019).

According to British and American scientists, the expected results of working in corporations are reasonable pay career growth, which is directly dependent on the efficient functioning of the company and structural units. Management is interested in stabilizing their position, predisposition to balance profits and risks, but their interests are not related to the

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growth of effectiveness of corporate relationships. The control parameters for this group are practically all aspects of the corporation's activities.

The aim of the research is to find ways of improving the accounting and control methodology, by establishing of which the financial situation of the enterprise will be evaluated objectively and the control will be activated, which is directly related to the correct and smooth accounting for the purpose of reaching the institution's goals and accomplishment of tasks (Pailodze & Kutateladze, 2018). The economic growth of the country, achieving sustainable economic development, development of production and solving social problems existing in the country can be created in the form of a tax system compatible with just-to-be and socio-economic conditions. The most easy way for management is to use technologies to get the most correct information (M. Sulashvili et al., 2018).

To strengthen the efficiency of accounting and control system it is necessary to improve Georgia's normative acts, the existence of complete information on financial performance of organizations and the results. This is only possible through using international accounting standards and fully harmonizing them with international standards (Dwi & Renny, 2017; M. Sulashvili et al., 2018).

Since the area of economic activity overshoots country's borders and the local legislation, international legislation as well as legislation of the country in which business relationships are carried should be taken under consideration, the process of audit of such type of operations is quite complex and lengthy process. Thus audit should be carried out by highly qualified specialists. The effective management of the company that is a precondition for economic growth and sustainability is depended on the reports prepared by auditors (G. Sulashvili & Murvanidze, 2017).

The analysis of state financial control environment gives us possibility to work out financial control, to the subjects and objects in the form of united system of financial control which makes possible to effectively execute functions of control for nurturing aims and assignments of financial control, adoption of financial strategies worked out by the enterprise with joint methods and means for control and providing increase of quality of efficiency (Boonvut, 2017).

In the modern conditions, application of modern informational technologies in audit activities has a significant role in increasing the productivity and ensuring increasing the quality of an audit of the operations of economic entities (G. Sulashvili et al., 2017).

Research Methodology

The theoretical and empirical basis of the research was provided by the papers of Georgian and foreign scientists dedicated to the internal control and internal audit functions of the corporation. The methodological basis of the research has become the dialectical method of studying economic events and processes. In addition, general and specific scientific methods of knowledge of events and facts were used.

The normative-legal basis of the research was established by the Civil Code of Georgia; Law on Accounting, Reporting and Auditing and Law on State Audit Office; Orders of the Government of Georgia and Individual Ministries.

The paper uses complex methodology for studying the topic, including methods such as: general thesis cognition, analysis and synthesis, induction and deduction. That was the result of the study of the theoretical value, which lies in the fact that re-occurred in the modern Georgian and foreign scientific achievements (papers, monographs, and periodic publications), consulting groups with the recommendations, regulations, local enterprises and organizations of the importance of internal documents just expressed in reference.

Results and Discussion

There is no uniform view about the essence of the internal control. In literature there may be different definitions of internal control: means, function and factor; type of activity, condition, method and event. From the position of four approaches, we define the essence of internal control: functional, systemic, processed and systemic-processed.

Functional approach means opening an understanding of internal control and internal audit through its functions. The characteristics of the control are in its role in the process of management. On the one hand, control is an integral part of each stage of management process (structural-functional form), on the other hand is a separate stage that provides information transparency on the quality of process at every stage (specialized form).

In structural-functional form of control, there is interaction between organizational structure units in accordance with its controlling functions. In the specialized form there is organization of internal control service or other controlling body with similar functions. Functioning of this service requires expenditures from the company; at the same time the results of the mentioned body are not always visible due to the preventive nature of its activity. The specialized form of control is used by medium and large companies or if such form is determined by law (G. Sulashvili et al., 2018).

Internal control is available in the following specialized forms:

- Audit Committee at the Board of Directors;
- Revision Commission;
- Internal Audit Service;
- Internal Control Service;
- Control-revision service.

The existence of one particular form of control does not mean the uselessness of other forms. For instance, in the company may a combination of different forms: the audit committee at the Board of Directors, the Revision Commission (in accordance with the law about Joint Stock Companies) and the Internal Audit Service. The efficiency of the corporate management system and the need for internal audit service will determine control forms (specialized or structural-functional). Priority organizational form of control depends on the complexity of the company's model, scale and its organizational structure.

Types of the model of the company are based on the forms of capital concentration: "private company", "top managers' collective property" (total or partial control of the company), "concentrate

d ownership of shares" and "scattered property". The model "private company" means the company's sole proprietorship and management, the most characteristic for small businesses.

According to the second model (collective ownership of top managers), the controlling stock of the shares is focused on top managers, who manage and control the company's activities. The owners will be in the form of executive managers, who, depending on the company's development strategy, are choosing between the effective structural-functional or specialized forms of control. The third model is "concentrated ownership of shares". The concentration of the shares of stock allows the owner to have complete or partial control, manage the company's activities and make the necessary decisions. The owner is interested to create an internal audit service in order to be informed for performing controlling function and for managing company effectively.

In the model "Scattered Property", owners do not actually control the company's activities; management and control is performed by top managers. In the protection of the rights of the owners (investors), a great impact is made by creation of an effective internal audit system, which is not always a subject of interest for the management of the company. Objectives for acquiring shares in proprietors who wish to earn profits may be different: one subgroup strives to make the current economic effect

(dividends), and the second subgroup seeks to make an economic effect in the future (increase of the share price). Accordingly, the requirements for internal control components are different for majority and minority (traditional, portfolio) shareholders. The first category of owners is interested to get full information on the corporation's activities; the key element for them is the efficiency of the business processes, the activities relevant to strategic goals.

The second category of owners is interested in receiving dividends and rising stock prices, the key element of their control - the corporation's performance in compliance with current legislation, profitability of the business and reliability of financial accounting [reporting]. Thus, the model type of the company, the organizational structure and the scope of the activity are important for the selection of organizational forms of control.

The system approach is internal control and audits as a system, in other words, the combination of interconnected elements intended to achieve the basic purpose. Any system can be viewed as a subsystem or other more complicated system, which in the form of individual elements in itself includes other systems. In terms of system approach, internal control (audit) consists of the following elements: objectives of controlling subjects, controlling subjects, objects of control (audit), internal control (audit), and control (audit) mechanism.

The systemic approach presents internal control and audit as a system; in other words, this is the combination of interconnected elements intended to achieve the basic purpose. Any system can be viewed as a subsystem or other more complicated system's element, which in turn contains other systems in the form of individual elements. According to systemic approach, internal control (audit) consists of the following elements: objectives of controlling entities; entities to be controlled, subject of internal control (audit), control (audit) mechanism. Objective - is a desirable condition or some sort of final result. In a broad sense, the goals themselves include intentions, targeted functions and time constraints.

Controlling subject is a legal or physical person. Corporate Governance System entities may belong to the management bodies and / or corporate officials responsible for the power of their respective governing bodies and are responsible for the objective impact of corporate relations. Thus, a controlling entity may be a state controlling body, owners (shareholders), investors (banks), management bodies or officials and internal controlling bodies (committee, service).

Controlled subjects are the subjects of corporate relations that may be corporation itself, founders (shareholders), management bodies, personnel (including the highest management), supplier contractors and corporation's competitors. Control object - this is an object that perceives controlling actions according to control objectives. Thus the activity of the Board of Directors is an object of internal control. The subject of internal control - is the existence, condition and / or action of a managed process. Also the subject of internal control is functioning aspects and actual situation of researched process.

It is advisable to distinguish between the control of the system of objects and the function of control of individual elements of objects oriented to objectives of any complexity. In terms of individual subjects participating in corporate relations, it is desirable to classify the internal control, i.e., classification of internal control by the importance of control subjects.

The Committee on Sponsoring Organizations of the Treadway Commission (COSO) and The International Auditing and Assurance Standards Board (IAASB) supported by the International Federation of Accountants (IFAC), define internal control as a process; such a view is reflected in the information of the Ministry of Finance of Georgia.

The process approach considers the control process that, according to ISO 9000: 2000, is comprised of a combination of the types of intercon-

nected activities that, by some technique, allows the user to change input and output.

At the input, the information is entered into the control process, at the output - the processed information about the object that has been obtained during the control. The information received at the output is for the subsequent decision making by the subjects of corporate relations.

For the establishment of effective structural bodies of corporate control, it is recommended to separate, on the one hand, control over the management and corporation activities and on the other hand control of the company's structural subdivisions by company management. The executive body of the corporation (general director) usually represents the last level of corporate management control.

In particular, by the process approach, that The Committee on Sponsoring Organizations of the Treadway Commission (COSO) defines internal control as a process, affected by an entity's board of directors, management and other personnel, designed to provide "reasonable assurance" regarding the achievement of objectives in the following categories: Effectiveness and efficiency of operations. "

Internal control is developed and implemented for the purpose of identifying business risks that prevent achieving any of the objectives. Progressive level control is represented by managers (heads of the company's structural subdivisions) who perform control functions together with their positions' functions assigned to them. In contrast to the process approach, the "internal control" definition is based on the system-processed position.

The systematic-process approach views the activities of controlling bodies as a system of processes that ensures achievement of the company's goals. From the position of this approach, the definition of the "internal control" is formulated that is not found in scientific literature: Internal Control (Audit) - This is a system of capacity enhancement (risk reduction) processes aimed at the company's tasks fulfillment. The difference between this definition and the definitions in scientific literature is that: First of all, internal control with authors of analytical works is regarded as a system or process (international and Georgian standards), while internal control is the system of processes; on the other hand, the goal of internal control is defined - to reduce the risks to achieve the goals of the company.

Thus, the role of internal control is shown as ensuring instrument to achieve set goals. The presentation of internal audit as a system of processes ensuring the achievement of corporate goals allows increasing the trustworthiness of corporate management audit reports; at the same time, the internal audit is a part of the internal control system that stands above and carries out "control of control". The number of publications about internal audit in the context of corporate governance issues has been increasing in recent years. This is the result of the business intensification process, since the creation of interdisciplinary knowledge - this is a strategic audit as a system of ideas that is an integration of two concepts: strategic management in the corporate governance system and internal audit. Thus, the concept of "internal control" has been formulated from the systemic-process approach. The economical essence of categories of "internal control" and "internal audit" is open and their relationship has been explained. Each category has a number of meaningful content, which is the type of activity, system and process. It is possible to talk about the existence of combination of interconnected elements that is integrated system of control and audit that functions to enhance the effectiveness of corporate governance.

Limitations and Future Research Directions

This study investigated the ways of improving the accounting and control methodologies for financial institutions. Authors believe that only a

small portion of this topic has been covered in this study and a lot more needs to be investigated in future. Specifically, scholars are encouraged to identify ways through which audit control can be improved.

Conclusion

The conclusion provides generalized results of the research and conclusions that internal auditors' activities are an additional resource that promotes the improvement of corporate management, risk management and control processes; Furthermore, the improvement of internal audit methodology in the corporate governance system in the framework of international practice contributes to sustainable development of the economy and, ultimately, represents an important tool for improving the social situation of society. The following conclusions can be made:

1. The scheme of conceptual framework of internal audit is drawn up to facilitate the opening of the methodological, organizational and practical aspects of the audit. Conceptual grounds will, in turn, regulate internal auditors' activities and define the directions of its perfection in the system of corporate governance;
2. The organizational scheme for the gradual conduct of the internal audit was developed, the basis for which is the algorithm of the method of inspection of the object analyzed, which in turn corresponds to the modern reality and enables further improvement of internal standards and audit documentation.

The results and recommendations of the research obtained in the work are directed towards development of theoretical, methodical and practical issues of internal audit in the corporate governance system. Future directions of the study are improving control mechanisms of business organizations.

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