

ASSESSMENT OF INTERNAL CONTROL SYSTEM IN LITHUANIA

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Abstract

The article analyzes the internal control system, the combination of its existentialism and effectiveness with regard to the fact that in present economic situation special attention is given to learning and prevention of frauds not only in Lithuania, but also in the entire world. During the last years when it was attempted to achieve long-term and effective management of the enterprises, the internal control became one of the main tools to implement these tasks, especially in the enterprises of such character, where frauds and mistakes are especially frequent. One of such sectors is extractive industry. The article analyzes the internal control system in the extractive industrial enterprises, defines concept of its effectiveness and the meaning, and performs survey of the state of internal control system in the Lithuanian extractive industrial enterprises.

Keywords: internal control, assessment of internal control system, frauds and mistakes, extractive industry.

JEL Classification: D21, L71, M41, M42.

Introduction

Each enterprise is unique for its performance, management policy and goals, although especially for extractive industry enterprises it is very important to know how purposefully materials and financial resources are being used and whether the enterprise's capital is not being embezzled or wasted. Maximizing the rational commodity of available resources and financial profit, the enterprise's shareholders aim to implement different forms and methods of internal control in the enterprise management system and thus to ensure its effectiveness. According to Giriūnas (2012) the internal control system is very important in all enterprises without any exception, be they large, medium or small. The specific performance and accounting of extractive industry enterprises have a huge influence not only on their internal control and its system, but also on its assessment. This is why the purpose of internal control is to manage business risk, i.e. to find the coordinated methods and means of the system of internal control so as to minimize the risk related to business environment, to the processes happening in the enterprise, and to generate the information that would be an essential background for making business decisions. Indeterminacy of these three types are common for every business, and managing to control them, i.e. to avoid, decrease, accept or divert them to the required direction provide an organization with the guarantee of success of its performance and a competitive advantage.

Nowadays, the rapid development of technology and economic pressure in the competitive environment make the enterprises change their attitude to internal control. This helps enterprises to achieve their goals through a set of certain rules and procedures. Among the foreign scientists that investigate the state of enterprise internal control system and its assessment, we should mention Barnabas (2011), Biegelman (2012), Gupta, (2010), King (2011), Pfister (2009), Simons (1990, 1995, 2000), Pickett (2010). In Lithuania, some aspects of this topic have been analysed by Kanapickienė (2008), Mackevičius (2003, 2011), Navickas (2011) and others. However, in scientific literature, for example Mackevičius, Kazlauskienė (2009), Campbell, Daniels, Dennis, Faber (2007) there is often expressed another non-traditional attitude stating that an effective internal control reveals the prospects of enterprise development and helps to notice threats to its existence, and so such a control becomes an important means of risk management.

The aim of the research is to analyze the state of internal control in the Lithuanian extractive industrial enterprises.

The objective of the research is to analyze the internal control system in Lithuanian extractive industrial enterprises.

To achieve the aim the following tasks were exercised:

- To identify the internal control and its importance for extractive industrial enterprises;
- To conduct the research on internal control in the Lithuanian extractive industrial enterprises;
- To determine the areas of internal control system, which have to be improved, in the Lithuanian extractive industrial enterprises.

The analysis of the scientific works, economical literature, and analytical works was carried out and the practice with regard to internal control, concept of its effectiveness and assessment was studied. Methodology to evaluate the internal control system was analysed combining together monographic, logical, statistical analysis methods and comparative approach.

Scientific research description and results

A preliminary analysis has shown that in Lithuanian enterprises that operate in the extractive industry sector there are not enough formalized procedures of internal control; the official distribution of responsibility is informal and ineffective, resulting in a weak internal control and consequently in mistakes in financial reports and frauds. These facts reflect the inefficiency of internal control. To identify and fight the reasons for intentional or unintentional mistakes and frauds, which usually emerge because of an insufficient level of internal control, becomes an essential necessity. According to Selim, McNamee (1998), Ittonen (2010), in case of big demand for raw materials in the market, the bigger part of money is attributed to extraction of resources and often this causes damages to internal control system, because due to negligent or bad attitude of the managers, the level of frauds, deceits and corruption gets very high (see Fig. 1).



Figure 1. Frequency of frauds and mistakes in extractive industry companies in USA

According to the done scientific researches, similar problems in the extractive industrial sector are present not only in other countries, but also in Lithuania, which in presence of favorable conditions for development of mistakes and frauds in the sector of extractive industry exactly in the area of resources, allow assessing the management of extraction of natural resources and its effectiveness using the internal control functions in the enterprise. According to the conducted research on the assessment of internal control system present in the companies of extractive industry, a relatively high number of deliberate and unintentional mistakes and frauds exists. Such results are determined by specific character of activity of the Lithuanian companies of mining industry and specific accounting system of the company.

It must be mentioned that the problem of uncertain practical assessment of internal control effectiveness is also complemented by the very specific accounting system which prevails in extracting industry enterprises. According to Vona (2011) the specificity is mainly influenced by the sphere of reserves, because they are not just produced or purchased like in production or sales enterprises; they are extracted by natural mining, and in their evaluation theory there are more than twenty different mathematical ways of calculation; by the way, a three-percent bias is allowed, which normally comprises quite a marked sum. It is in reserves accounting that an extractive industry enterprise can vary not only the extracted amounts, but also account for certain natural conditions; for example, wet digging obtained during the rainy weather would be heavier than the one extracted in a dry period. Thus, the accounting particularity in this sphere of industry determines the necessity of a model of assessing the effectiveness of internal control to prevent the conditions for the enterprise's employees or authorities to make intentional mistakes or frauds; besides, such identifications in accounting are practically impossible.

The done research allows stating that the mistakes are encountered in all the Lithuanian companies of mining industry without any exception, but their assessment is very different and depends on the fact whether they cause any financial losses, because majority of mistakes may be insignificant and they can be quickly found and corrected. However, according to the results received during the research it is possible to state that the Lithuanian companies of mining industry have ineffective internal control system, which affects the existence of mistakes and frauds. To find out the problems that occur in the internal control system of an enterprise and that cannot be easily audited, an essential condition becomes to evaluate the connections of assessment criteria, relations among mistakes and frauds, and the weak points that create conditions for mistakes and frauds. For this purpose, a questionnaire survey of internal control and its present state assessment was carried out in Lithuanian enterprises of extractive industry. The results of the survey have shown that the assessment of the internal control system may be performed more objectively and enables to compile its model with regard not only to the particular spheres of enterprise performance, but also to the weak points causing mistakes and frauds. The analysis of fraud should be done presuming that the companies will not reveal for sure that they execute and initiate frauds, that 71,23 per cent, i.e. 52 from 73 companies of mining industry acknowledge that the frauds happen. Thus it is possible to state that such results and their size are essentially unexpected. However the frauds in these companies are initiated by the company's employees and not by the management, and of course their existence may become known just from the special services. Besides, according to the respondents, the most frequent frauds are difficult to prove even on the company's level, because they are executed not by one employee, but by their entire chain.

The results of the research when it is attempted to determine the conditions favourable to appearance and development of frauds and mistakes allow stating that they may be divided into peculiarity of the accounting of mining companies, improvement of qualification of accounting employees, change of staff, peculiarity and technology of the company's activity. When the respondents were asked to answer, what determines such range of deliberate and unintentional mistakes and frauds, they stated that the main reason could be considered the accounting peculiarity of the mining company, as it is possible that the internal control will not find mistakes and frauds on the basis of information provided by the accounting system alone (see Fig. 2).

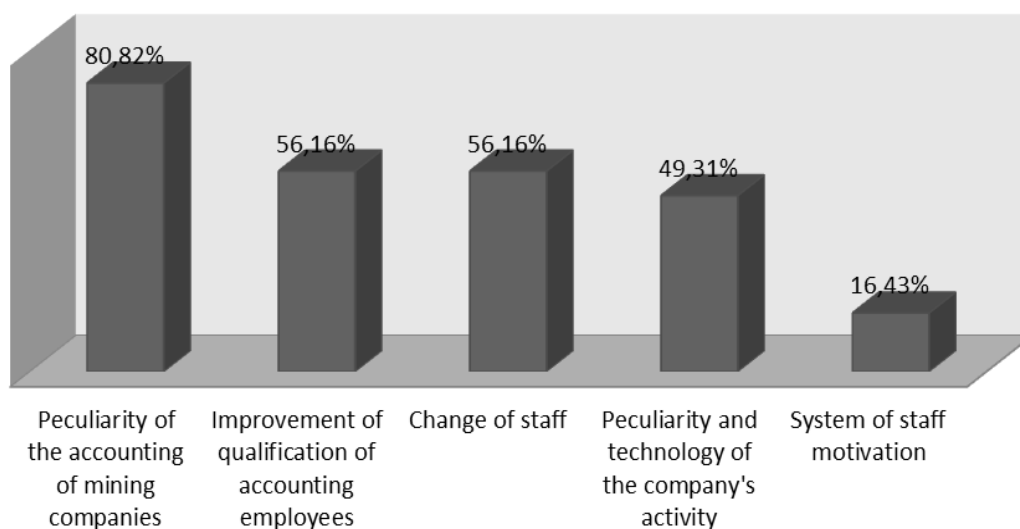


Figure 2. Group of conditions, which result in presence of mistakes and frauds

All the presented conditions allow stating that the most frequent mistakes are caused by the accounting peculiarity of the company, which is determined by complex accounting policy of resources and quite difficult tax basis that is different from the tax basis of other manufacturing or commercial companies. In such a case the main difference is exactly the sale-purchase accounting because the purchases of resources do not exist in the mining companies, as the sales have to be coordinated with the norms provided in the extractive permits of natural resources. Usually the mistakes are determined by the particularity of enterprise's accounting, which is caused by difficult accounting policy of the resources and quite difficult tax base that differs from other manufacturing or commercial enterprises. In such a case Ажгирей, Брешенков, Прокофьев, Русинов (1954) suggest to consider the accounting of sales-purchases to be the main difference,

because purchases of resources are not present in the extractive industrial enterprises, especially as the sales have to be adjusted to the norms determined in the extraction permits of natural resources. Thus the sale process is the main area, where the internal control has to be especially profound because different to the sale process, the frauds and mistakes may be equally controlled by the enterprise's management and employees. Besides, the person executing internal control has to be familiarized with the particularity of activity and technologies of the Lithuania extractive industrial enterprises, and to have big work experience in this area. Looking from the side of purchase process, it has to be mentioned that their mistakes and frauds are usually initiated by the enterprise or its management, and not by the employees, thus the effectiveness of internal control is determined by external factors due to the organizational structure of the enterprise and certain relations of subordination, thus the work experience of the employees or familiarization level with the activity's particularity remain insignificant. Thus the demand for qualified personnel of accounting sector, who are familiar with the management of accounting of companies of similar character, thus following the research results, the employers are always searching for the personnel of the highest and not high qualification. This first of all induces change of accounting staff, but it also has to be mentioned that frequent change of staff creates favourable conditions for development not only of mistakes, but also of frauds. According to Dechow, Ge, Schrand (2010), the majority of frauds appear not only because of poor effectiveness of internal control, but poorly motivated personnel of the company are the weak link of any organization. The same result is also presented by the performed research, on the basis of which it is possible to state that the especially flexible motivation system of employees should be implanted in the company of mining industry that also affects the changes in frequency of change of personnel.

The accounting particularity of the Lithuanian extractive industrial enterprises determines that the mistakes committed by the employees initiated by fraud are almost equal to frauds initiated by company or its management. Thus as the staff of the Lithuanian extractive industrial enterprises may initiate the frauds successfully, the persons executing internal control need big work experience in the enterprises of such kind, also they have to be well familiar and know the accounting particularity of such enterprises in relatively high interpretative level. The effective internal control system present in the extractive industrial enterprise may become unsuitable or even ineffective when the circumstances change, thus the assessment of its effectiveness is one of the tools to improve the accounting policy, to protect the company's assets, and to secure the correct accounting and effective activity. According to the research results of extractive industrial enterprises, they have ineffective internal control system because the deliberate or unintentional mistakes are encountered in all the analyzed enterprises without any exception; the majority of analyzed enterprises encounter frauds initiated by the employees; the present frauds and mistakes allow making the presumption that at least one or more weaknesses exist, which create conditions for development of frauds and mistakes.

Conclusions

- The results of the questionnaire survey have shown that the internal control system existing in enterprises operating in extractive industry is not effective enough; particular attention must be paid to certain spheres of performance while compiling the model of assessing the internal control system effectiveness. Also, if there are no intentional or unintentional mistakes or frauds mainstreaming in the enterprise, it is possible to state that its internal control system is effective.
- An effective internal control system enables to decrease the danger that the goals of an enterprise will be missed. However, there is still some risk that internal control will be poorly organized or will not operate as expected. Since the quality of internal control depends also on the human factor, there might appear some drawbacks in its arrangement, assessment and interpretation, misunderstandings, distractions, tiredness, negligence, secret deals, misuse, and disregard.
- According to the research results of extractive industrial enterprises, they have ineffective internal control system because the deliberate or unintentional mistakes are encountered in all the analyzed enterprises without any exception; the majority of analyzed enterprises encounter frauds initiated by the employees; the present frauds and mistakes allow making the presumption that at least one or more weaknesses exist, which create conditions for development of frauds and mistakes.

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