

Internal Control: Is it a Benefit or Fad to Small Companies? A Literature Dependency Perspective

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The COSO internal control integrated framework addresses the operating effectiveness and efficiency, reliability of financial reporting, compliance with applicable laws and regulations, and the safeguarding of assets. Organizations and their internal control needs vary significantly by industry, size, purpose, management philosophy, diversity and complexity of operations, local culture and operating environment, and legal regulatory requirements. Small companies are highly susceptible to mistakes spawning from the poor planning, organization, and control of procedures in their operations. Hence, management personnel are faced with the challenges of devising measures to promote operational efficiency and ascertain that all of the financial reporting goals are met. Although small companies are faced with challenges to implement internal control systems because of various limitations such as costs, few employees and other constraints, it is worthwhile to note that effective internal controls can still be possible.

INTRODUCTION

Internal control has been an integral part of businesses for centuries, but confusion exists over the exact meaning and scope of the term (Apostolou & Crumbley, 2008). Historically, the term *internal control* applies to the domain of accounting and its efforts to safeguard assets and ensure the accuracy of accounting records (Apostolou & Crumbley, 2008). According to Grandell (1977), internal control began with the earliest known records of commerce in the Mesopotamian Valley in 3500 B.C.E. and continued through the Middle Ages. Edler (1934) purported that in the absence of paper, tally sticks were used to conduct internal control activities. Unsplit tally sticks started as mathematical objects serving as mnemonic aids to counting (Kuter, 2009). In addition, tally sticks provided the earliest form of bookkeeping for record keeping (Baxter, 1989). Although evidence of the practice of internal control can be traced back to 3500 B.C.E, little has been written about it by scholars as a discrete subject (Apostolou & Crumbley, 2008). Since the early 1900s, accountancy writers have paid more attention to internal control and its effect on organizations (Grady, 1957).

There is no literature to support any reliance on internal control as a part of the attest function from ancient time to 1850. The audit objective was primarily to detect fraud. The industrial revolution from 1850 to 1905 garnered the need for corporate audits. The audit objectives during that time was detection of fraud and clerical errors. There were some evidence based testing but no reliance on internal controls in the audit process. The development of the stock markets in 1905 to 1940 resulted in more emphasis on earnings. The audit objective was determination of fairness and detection of fraud and errors. Because of the complexity and the voluminous nature of corporate companies' transactions and activities the audit

process required an increased emphasis on testing and slight reliance on controls. During the period 1940 to 1975 the audit standards were developed. As a result, the audit objectives focused on determination of fairness. The audit process included substantial reliance on controls. During the period of 1975 to 1985, internal control was included in the audit process to determine the scope of audits. The period 1985 to 1995 fostered an increased demand for reporting on compliance and internal controls. The audit process required risk assessment to ascertain the scope of the audit and risk of fraud. The period 1995 to present included guidelines from COSO and Sarbanes Oxley Act of 2002. The audit objective is determination of fairness and the audit process is the focus on business risk.

Jackson (2006) asserted that internal control has its roots in the Great Depression, which began in 1929 when the stock market crash destroyed public confidence in the stock market and the U.S. economy. The crash was blamed on wildly inflated stock prices, poor monetary policies, fraud, concealed or misleading financial information, the rampant buying of stocks on margin, and inadequate controls.

The Securities Exchange Act (1933) was enacted to assure investors of the transparency of securities being sold and to prohibit deceit, misrepresentations, and other fraudulent securities actions. The Securities Exchange Act (1934) was enacted to give the government power to regulate many aspects of the securities industry (Jackson, 2006; Campbell & Campbell, 2006). The act provided the Securities Exchange Commission with the authority to require the periodic reporting of financial information by organizations that offered publicly traded securities, and have the power to register, regulate, and oversee the industry.

Public companies have been required to establish and maintain internal accounting control since the enactment of the Foreign Corrupt Practices Act (1977). However, the term *adequate* was not clearly defined. In response to this requirement, most companies developed their own approach to compliance through the cooperative efforts of management, internal audit, and external auditors (Marchetti, 2005). Under Section 404 of the SOX, public companies must attest to the effectiveness of their internal control over financial reporting when they file their annual reports (Campbell & Campbell, 2006). Although laws on internal control are relatively recent, Section 404 was meant to spotlight the connection between strong internal control and reliable financial statements (Harrer, 2007).

The corporate scandals of the 1980s saw many people lose their jobs. COSO was formed in 1985 to identify the various factors that can lead to fraudulent financial reporting and to develop recommendations to address these issues (Kieso, Weygandt, & Warfield, 2005). In 1987, COSO published its findings of the gross corporate irregularities of the 1980s. The report indicated that fraud occurred because of improper internal control that included not only financial statement controls but also certain environmental, institutional, or individual forces and opportunities ([COSO], 1987).

As part of COSO's work in identifying the factors that contributed to corporate fraud, the members also designed a model for corporations to use to address the lack of proper internal controls in corporate organizations (Jackson, 2006). In 1992, COSO established the internal controls integrated framework for developing an effective internal control system. This framework provides direction to any business that wishes to establish an effective internal control system. This now recognized framework consists of five interrelated components: control environment, risk assessment, control activities, information and communication, and monitoring ([COSO], 1992).

These five major components of the COSO (1992) internal control integrated theoretical framework are part of a holistic framework needed to strengthen efficiency within the management of any organization. Throughout this holistic framework, a variety of activities and steps are taken to ensure that the organizations do not provide opportunities for the manifestation of fraudulent behaviors by employees ([CSOS], 1992). The framework created based on these components is constantly assessed for clarity so that the implemented internal control functions throughout the lifespan of the organization ([COSO], 1992). The five components of internal control also work harmoniously to detect, prevent, or correct errors or misstatements in the overall operations of the business ([COSO], 1992). For the process of internal control to be seen as viable, all of the financial statements generated from all business activities must be authentic and noteworthy in accounting terms.

Control Environment

According to COSO (1992), the control environment sets the tone for an organization by influencing the control consciousness of its people. It is the foundation for all of the other components of internal control because it provides discipline, structure, integrity, ethical values, employee competence, management's philosophy and operating style, and the leadership provided by senior management and the board of directors.

Risk Assessment

Every organization, be it private or public, large or small, faces risks from external and internal sources that must be assessed. A precondition to risk assessment is the establishment of objectives that are linked at different levels and are internally consistent. Risk assessment is the identification and analysis of risks relevant to the achievement of objectives ([COSO], 1992). This assessment determines how the risks should be managed ([COSO], 1992). 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 policies and procedures that ensure how management directives are executed. Control Activities include such activities as approvals, authorizations, verifications, reconciliations, reviews of operating performance, the safeguarding of assets, and the segregation of duties. These actions dissuade fraud or theft activities that could eventually lead to losses (COSO, 1992).

Information and Communication

Pertinent information must be identified, captured, and communicated in forms and timeframes that enable people to carry out their responsibilities. Information systems produce reports of operational, financial, and compliance-related information that make it possible to run and control the business (COSO, 1992). Information systems deal not only with internally generated data but also information about external events, activities, and conditions necessary to informed business decision making and external reporting. Effective communication also must occur in a broader sense by flowing down, across, and up the levels of the organization (COSO, 1992). All personnel must receive a clear message from top management that control responsibilities must be taken seriously. Employees in an organization must understand their own role in the internal control system, as well as how individual activities relate to the work of others. Employees must have a means of communicating significant information upward. Effective communication also must exist with external parties, such as customers, suppliers, regulators, and shareholders (COSO, 1992).

Monitoring

Monitoring is a process that assesses the quality of the internal control system's performance over time through ongoing monitoring activities, separate evaluations, or a combination of the two (COSO, 1992). Ongoing monitoring occurs in the course of operations. It includes regular management and supervisory activities as well as other actions that personnel undertake while performing their duties. The scope and frequency of separate evaluations depend primarily on an assessment of risks and the effectiveness of ongoing monitoring procedures (COSO, 1992). Internal control deficiencies should be reported upward, with serious matters reported to top management and the board of directors (COSO, 1992).

Sarbanes-Oxley Act

Sarbanes Oxley Act (SOX) was enacted in response to corporate irregularities and the implosion of many companies in 2001. SOX was described as the most far-reaching reform of U.S. business practices since the Securities Act of 1933 (Jackson, 2006). The purpose of SOX was to improve quality and transparency in financial reporting and independent audits, strengthen the independence of firms that

audit public trading companies, and increase corporate responsibility and the usefulness of corporate financial disclosure (Foley & Lardner, 2005). Although SOX was passed primarily in response to wrongdoing and fiscal mismanagement in public companies, one of its outcomes has been greater accountability within the private sector, regardless of the size and status (private vs. public) of the company.

Section 802 of SOX amends the federal obstruction of justice statute. It is now a felony to knowingly destroy, conceal, cover up, or falsify documentations or records to impede or obstruct federal investigations. SOX imposes fines and up to 20 years in prison for knowingly destroying, altering, or falsifying records with the intent to impede or influence federal investigations, including existing or contemplated government proceedings against private companies (Foley & Lardner, 2005). Section 806 of SOX, under the whistleblower protection act, purports that it is against the law for employers to discriminate or take action against employees who disclose information or evidence against fraud or irregularities.

Although SOX were not expressly applicable to private companies, many of the requirements imposed by SOX have become best business practices and are now considered industry standards. The pressure on private companies to comply with SOX is coming from many different directions. Lenders, insurers, public merger partners, potential litigants, and state governments are all looking at the SOX-type control mechanisms installed by private companies (Foley & Lardner, 2005). It must be noted, however, that private companies are not required to be in technical compliance with SOX (Foley & Lardner, 2005). As such, private companies can pick and choose the provisions that they want to adopt. Private companies seem to be implementing most of the easier changes, such as adopting a code of ethics for officers and appointing independent directors and audit committees (Foley & Lardner, 2005). The provision of SOX that affects private companies more adversely is Section 404, which requires companies to report the effectiveness of internal control over financial reporting at the end of each fiscal or calendar year (Foley & Lardner, 2005). This provision requires a report of an external auditor attesting to management's assertion of the effectiveness of the internal control in the organization (Foley & Lardner, 2005; Marchetti, 2005).

LITERATURE REVIEW

Doyle et al. (2006) explained that material weaknesses in internal control are more likely in firms that are smaller, younger, financially weaker, and more complex in structure. Although the size, age, and financial resources of the firm affect its ability to establish proper internal control, the need for internal control is unique to each firm's particular operating environment. Doyle et al. (2006) examined 970 companies that reported material weaknesses from August 2002 to August 2005. Doyle, Ge and McVay (2006) reported that the firms that were in the growth stage were financially weaker and small, were engaged in restructuring activities, and were more likely to have internal control weaknesses.

Ashbaugh, Collins, and Kinney (2006) supported the findings of Doyle et al. (2006) by studying a sample of 585 firms that had disclosed internal control deficiencies and another test sample of 5,281 firms that had not disclosed internal control deficiencies from November 2003 to December 2004. According to Ashbaugh et al., the larger firms with more complicated operations such as mergers and acquisitions were more likely to find and report internal control deficiencies. Ashbaugh, Collins and Kinney (2006) study was different from that of Doyle et al. in that the latter researchers restricted their analysis only to firms that had reported "material weaknesses." Ashbaugh et al. considered all three levels of internal control deficiencies, namely, material weaknesses, significant deficiencies and control deficiencies, as set forth by the Public Company Accounting Oversight Board (2004).

Duncan (1995) conducted a survey of 1,200 churches to determine the effects of internal control. Six hundred survey questionnaires were sent to churches with more than 300 members, and 600 surveys were sent to churches with fewer than 300 members (Duncan, 1995). Duncan concluded that the churches with more than 300 members had adequate or better internal control systems.

Ge and McVay (2005) examined a sample of 261 companies that disclosed at least one material weakness after their effective date of compliance under SOX. The researchers concluded that a cause for the deficiencies was the insufficient commitment of resources to maintain and design accounting controls (Ge and McVay, 2005). One possible solution to the problems studied by Ge and McVay could be for companies to hire better managers and employees to run their businesses.

Coe and Ellis (2001) conducted a study of 127 cases of public officials who were prosecuted for fraud in North Carolina. The purpose of the study was to ascertain the effect of internal control failure in state-run organizations (Coe & Ellis, 2001). The findings indicated that city or county losses were more likely to occur in departments where cash was handled (Coe & Ellis, 2001). Coe and Ellis also stated that failure to segregate duties and use pre-numbered documents were the most common reasons for losses.

Sardino (2007) as well as O'Connor, Vera, and Chan (2007) concluded that a firm's operating performance is directly related to the fit of the firm's operating strategy with the management control system that has been implemented. O'Connor et al. collected data from three sources: a sample list of firms, a financial and market database, and a comprehensive survey of managers of Chinese-listed firms. The chief executive officers of the firms were contacted by telephone and invited to participate in the study (O'Connor, et al, 2007). The survey instrument was then mailed to 659 companies; the response rate was 27.8%. O'Connor et al. concluded that internal control does not work independently, but is more successful when working in collaboration with the firm's operating performance and strategy (Sardino, 2007).

Kistler (2008) examined the extent of and reasons for the lack of internal controls within Protestant worship centers congregation using a for-profit internal control questionnaire. Kistler concluded that the levels of internal control in the Protestant churches were viewed as insufficient when compared to for-profit companies' standards. The implications of the findings indicated that the financial assets of the Protestant churches were vulnerable to fraud and abuse (Kistler, 2008).

Campbell, Campbell, and Adams (2006) explained that internal control sets the overall tone of the operational functions of the organization. Ethical values, leadership, resource allocation, staff competence at all levels, the dynamics of authority and responsibility within the organization, and management philosophy are part of this critical component. Jensen (1993) posited that there are tradeoffs for proper internal controls. Jensen further suggested that some control mechanisms are inherently more effective at mitigating managerial waste and protecting company's resources. However, Jensen also suggested that internal control systems have historically failed to respond quickly enough to protect resources.

Brown (2006) argued that internal control activities can reduce or eliminate theft and pilferages in restaurants. Lynn (2006) postulated that employee theft can have a serious impact not only on small companies' profitability but also on the morale of other employees who may be aware of what is going on. If basic internal control systems are in place, then workers know at each step of the way that they will be held responsible for shrinkage (Ridley, 2008). Internal control systems help to establish proper rules for consistency and prompt reporting, and they set up the efficient flow of paperwork and data collection. Brown acknowledged that although no system is perfect, a good internal control system will show where fraud or loss is occurring.

Small companies may be more vulnerable to theft than large ones because thieves realize that smaller businesses do not have the resources to set up elaborate security systems or internal control systems. Therefore, the security in small companies must be evaluated as a management function. To be effective, security policies and procedures should be clearly defined and specific responsibilities should be given to various individuals.

Internal control measures are intended to prevent a fire, not put out a fire. The key reason for internal control in organizations is to prevent loss before it occurs, not detect losses that have already occurred. By preventing losses through fraud and theft, internal control gives management a glimpse of the actual performance of the business in terms of profitability and cost management (Manne, 1987).

CHALLENGES OF INTERNAL CONTROLS IN SMALL COMPANIES

Lucier (2001) argued that management must always know the position of the business: whether it is growing or shrinking, whether amassing profit or going down the hill as a result of losses. Once management knows the stability and capability of the business, they can then make decisions that lead to growth and expansion of the company (Lucier, 2001). The majority of family-owned businesses have had concerns about internal controls overridden because of the level of trust based on the special relationships among the family members involved (Aronoff & Ward, 2007). This relationship, however, can become problematic because of expansion of the business (Aronoff & Ward, 2007). Furthermore, when employees without any previous relationship with the business owners are hired, the importance of regulating control structures becomes a necessity (Aronoff & Ward, 2007).

Internal controls provide reasonable, but not absolute, assurance that specific entity objectives will be achieved. Even the best internal control may break down because of an error in human judgment in the decision-making process. Controls, be they manual or automated, can be circumvented by collusion. Management also has the ability to override internal control. Cost constraints such as the cost of internal control should not exceed the benefits expected to be derived. Custom, culture, and management systems in restaurants may inhibit fraud, but they are not absolute deterrents (Whittington & Delaney, 2009).

No system of internal control is without weaknesses. As long as control procedures are performed by people, the internal control system will be vulnerable to human error. Errors may arise from misunderstandings, mistakes in judgment, carelessness, distraction and fatigue (Roth, 1997). Separation of duties can be defeated through collusion by employees who secretly agree to deceive the company. In addition, established procedures may be ineffective against employees' errors or dishonesty, and controls that were initially effective may become ineffective when conditions change. In some cases, the cost of establishing and maintaining elaborate systems may exceed the benefits. In small businesses, active involvement by the owner can be a practical substitute for the separation of some duties.

Epstein and Myers (2005) explained that internal control structure may be unfit for a small business that has few employees. One person may perform two or more duties at a time. This may result in negligence on the part of the staff and the quality of the work may be affected (Epstein & Myers, 2005). The authors further argued that the purpose of the internal control may not be achieved and the cost of the internal control may exceed the cost of errors and frauds (Epstein & Myers, 2005). In addition, management may not care if internal controls work properly (Ridley, 2008). Management and staff can at times view internal controls as red tape, unnecessary and a waste of time. In a small business staffs are under tight budgets and will be tempted to cut corners (Harrer, 2007).

A rigid internal control system may be grounds for apathy amongst staff which may lower their morale through bad supervision in the way the duties are delegated. The design may not be suitable for the type of business or organization and be difficult to sustain (Harrer, 2007). Management may place over-reliance on internal control system causing employees to carry out fraudulent activities (Coe & Ellis, 2001). A strong internal controls system may cause auditors to over-rely on the system, therefore relaxing applicable audit procedures which may lead to losses in the business (Michelman & Waldrup, 2008; Jackson, 2006).

Increases or decreases in small companies overall operational costs depend on the controls put in place by an organization. Money alone cannot buy profitability. For example, certain internal controls measures are inappropriate for a small companies having fewer than 10 employees but may be appropriate for a large companies. The cost associated with such controls must always be compared to the expected benefits before implementation.

BENEFITS AND RECOMMENDATIONS

Internal controls may be used effectively to keep track of the costs incurred in the course of operating a small company. Knowledge of these costs is generally useful in planning and decision making with the aim of reducing or eliminating some of the costs (Epstein & Myers, 2009). The controls also take into

account the organization plan, along with policies implemented within a small company to safeguard its assets, check the accuracy and reliability of its accounting data, promote operational efficiency, and promote adherence to prescribed managerial policies (Simmons, 1997).

Through internal control, transactions are authenticated and recorded properly, which assists in the proper preparation and maintenance of financial statements. Overall, small companies use one of two categories of internal controls: preventive and detective controls (Galloway, 2003). The preventive controls are measures put in place to minimize or eliminate any questionable errors or irregularities that may occur on an everyday basis, and they normally involve the incorporation of best practices within the industry with regard to operational and other procedures. Detective controls are investigative in nature and normally attempt to identify errors or misappropriations. Detective controls depend greatly on the proper implementation of preventative controls, which provide the necessary records needed during investigative processes. Internal controls may be used effectively to keep track of the costs incurred in the course of operating small companies. Knowledge of these costs is generally useful in planning and decision making with the aim of reducing or eliminating some of the costs (Epstein & Myers, 2009). The controls also take into account the organization plan, along with policies implemented to safeguard its assets, check the accuracy and reliability of its accounting data, promote operational efficiency, and promote adherence to prescribed managerial policies (Simmons, 1997).

The division of labor is a preventative control mechanism employed by most companies. In so doing, various sections are operated and managed by different personnel, which also necessitates internal transfers to reduce the incidence of collusion and the lack of productivity resulting from boredom. Separation of duties ensures the security of various assets and proprietary information of the establishment. Frequent and unexpected changes or transfers are advisable to reduce collusion among staff members who may have fraudulent intentions. It is important that employees are educated about the importance of observing and adhering to the various internal control measures put in place all times especially when companies are small and communication becomes an effective part of the internal control process.

Some of the important components of an internal control system are accounting and finance controls, administrative and managerial controls, inventory controls, purchasing controls, cash controls, and sales statistics, and budget preparation. Accounting and financial controls are measures that ensure that all the financial statements such as the cash flow statements, balance sheet statements, income statements, and retain earning statements are well kept and reliable for use by the management (Rutherford & O'Fallon, 2007). To be able to have a concise record of the company's finances, it is important for the management team to review the financial records on an ongoing basis so that leakages or errors that might happen during business transactions may be traced and corrective action taken.

The accounting system must be well instituted so that a systematic process is followed when dealing with accounting tasks and activities. An outside auditor should be brought in on a regular basis to review the accounting work by checking for legality and inaccuracy so that errors or fraud might be detected (Martin, 1989). Bookkeeping should also be up to date, well secured, and stored securely to avoid loss of information (Coltman & Jagels, 2001). The company's accounting books and financial records should be safeguarded and easy to access so that management can have information on hand for easy and fast decision making (Coltman & Jagels, 2001). Another effective internal control measure is to outsource the accounting department and focus on value added activities. This would enhance the reliability of the financial statements because an independent, objective third party that has no connection to the company would be preparing them. In addition, it might be less costly to outsource the accounting function to a CPA firm.

The prime objective of a business is to provide an adequate return on the owners' investment in the business. Some small businesses are largely made up of small transactions and diverse activities. Transactions are conducted rapidly and often under rushed circumstances (Alonzo, 2007). According to Alonzo (2007), "for that reason, it is important to keep tight control over all profit centers" (p. 137). The basic accounting concepts related to the measurement of income must serve as a guideline for the proper recognition of revenues and expenses, thereby ensuring accuracy and uniformity of income measurement.

The income statement can be used as a valuable analytical tool. Its percentages reveal good performances as well as problem areas that need attention (Kieso & Weygandt, 2005). Industry statistics for similar operations may be obtained and used in the comparison of other companies' performance (Alonzo, 2007).

Cash flow is the money generated in the operation during the operating period. Cash flowing into the organization is used to pay off obligations plus other costs (Coltman & Jagels, 2001). Cash flow represents the actual money left over at the end of the period without the artificial contrivances of general accounting practices (Coltman & Jagels, 2001; Epstein & Myers, 2009). All small companies need cash to operate. Because of such accounting conventions as the expensing of depreciation on assets and the accruing of certain expenses not yet payable, the usual financial statements do not completely show what cash is really available to the operators (Coltman & Jagels, 2001). Operations may do well and be profitable from an accounting viewpoint, but poor managerial decisions, such as allowing inventory levels to rise and inappropriate internal control, may leave little money left to pay creditors when their bills are due. Dollars, not book profits, are needed to actually pay the bills. Therefore, management should know the cash flow and the impact on future cash flows before making certain expansions and capital investments.

The most common measure of how well a business is performing is to calculate the ratio of net profit to total average assets. This ratio is called a return on assets, and it shows how well the assets entrusted to the management have been used (Bragg, 2005). Another way of measuring the financial health of an enterprise is to calculate the return on investment (Barrows & Powers, 2006). The return on investment is the amount of money obtained as profit in relation to the actual amount invested by the owners of the firm.

Buckhoff and Clifton (2003) explained that cash-intensive businesses are vulnerable to off-book fraud schemes. Few people will steal if they think they will be caught and suffer serious negative consequences (Buckhoff & Clifton, 2003). Accordingly, the most effective deterrent is to instill the perception of detection in employees' minds. If managers do not pay enough attention to cash flow, which essentially tells how much money is in the business, small companies will fail to survive. Without knowledge of the cash flow, managers suffer the consequences of insolvency.

Cash controls include a list of activities that small companies are involved in with regard to the handling of cash and the receipts obtained from transactions carried out by personnel, who may include, but are not limited to, cashiers, the management team, the bookkeepers, and the accountant. The best practice concerned with cash control is the creation of an orderly flow of cash in and out of the companies' coffer (Bragg, 2005). Having an accurate account of all cash or receipt transactions is integral to balancing the accounting books; if the records analyzed are on par with the records kept on cash, then the internal control is deemed reliable (Martin, 1989).

Cash, check, and credit card controls have to be in place to reduce theft (Barrows & Powers, 2006). Cash is the asset most often stolen by dishonest employees (Miller, 2006). Fraudsters typically target cash as it enters or leaves the business (Buckhoff & Clifton, 2003). Thoroughly understanding the controls and procedures in place for processing cash flowing through a business makes this type of scam much more difficult (Buckhoff & Clifton, 2003). Today, the Point of Sale System (POS) makes this type of scam much more difficult (Brown, 2003). More small companies are switching from traditional cash register to a POS (Godsmark, 2005). With the right POS, the small company can increase the efficiency and control of its operations.

Buckhoff and Clifton (2003) contended that inadequate cash flow controls, especially over substantial amounts, allow dishonest employees to divert cash into their own pockets. Understanding these cash controls allows managers to generate and implement appropriate controls to counter the occurrence of fraud (Epstein & Myers, 2009). To maintain adequate cash flow, managers should set up a consistent payment schedule for non-controllable expenses, such as loan payments, rent, insurance, and equipment leases; deposit cash sales every day; avoid over purchasing, regardless of the volume discount; not to tie up cash in excess inventory; set up a budget plan to pay for utilities such as gas and electricity; and pay the bills in a timely manner.

Inventory controls help management to assess the flow of purchased goods in order to establish any odd trend (Martin, 1989). Success in managing a company, small or large, is essentially a matter of how well the manager understands the importance of inventory control (Sanders et al., 2008). Management can adjust to accommodate special purchases in emergency situations. In order for a small company to establish efficient inventory control, the manager must stock a manageable supply based on the needs of the company and make a habit of routinely track inventory. Adequate supplies must be on hand, with some extra being stored for emergency backup (Godsmark, 2005; Lee, 2006). However, small companies should avoid tying up cash on excess inventory because this situation may encourage pilferage (Godsmark, 2005). The more inventory there is on hand, the more likely it will be that employees may want to steal or pilfer some of it. Storage steps should include control procedures. The order of management of items should follow some logical method of use, such as first in first out or last in first out (Lee, 2006).

A core inventory reduction problem is a company's reliance on a demand forecast, which inherently reduces the risk of demand inaccuracy based on the perception of management creating the forecast (Bragg, 2005). Just-in-time philosophy may be implemented to control inventory costs. This philosophy addresses the need of inventory when utilized. Raw materials or supplies are not purchased until there is a need or an element of certainty that they will be needed (Alonzo, 2007). The proper kind of product and or service, quantity, and quality must be determined and the right supplier found. Many aspects of the purchasing function can be computerized for greater efficiency (Lee, 2006). When recipes are input into available software system that are linked with production scheduling and a front-of-house point-of-sale system, utilized items are subtracted from inventory. Management are signaled when it is time to order more recipe components. Similarly, recipe component costs can be monitored so that management are alerted when supply item prices have climbed above a range deemed acceptable. Substitutions can then be suggested that are acceptable.

Purchasing supplies and goods is not simply deciding what, when, and how much; rather, it requires further efforts in accounting, controlling, and monitoring the flow of materials within the operation from the initial receipt until they are used. All of these functions must be well coordinated, organized, and simplified as much as possible (Fields, 2007; D. Miller, 2006). Management should scrutinize the purchasing system to determine whether any procedures can be streamlined or eliminated. The system should provide procedures for an adequate flow of information between departments and the maintenance of good records to provide accountability.

The quantity purchased should be held to the lowest possible amount, with safeguards against running out. Usually a small company calculates its average use of items and establishes minimum and maximum levels of stock between deliveries. Goods purchase requisition should be the basis for purchase orders. Only those employees authorized to buy goods should have access to purchase requisitions or purchase orders, which should be signed by management or the highest purchasing authority. A record should be maintained of all purchase orders for supplies used in the company (Miller, 2006; Moncarz & Portocarrero, 2005). From the purchase order, a daily receiving report should be set up, indicating the product or service orders expected for delivery on which days, how much was ordered, and the price.

Orders have to be formalized and maintained through a filing system so that management will be able to trace all orders made (Moncarz & Portocarrero, 2005). The products delivered must be recorded for future reference to help the organizing team detect mistakes or fraud and assist management in putting measures in place to curtail such future activities (Rutherford & O'Fallon, 2007).

Administrative or managerial controls are measures established in a business operation that guarantee that the business operations are proficient and efficient enough to garner maximum benefits (Burton, Carrol, & Wall, 2002). These controls also ensure that the management team can keep abreast of the company's managerial policies, which have to be upheld for business to be conducted with integrity (Burton et al., 2005).

Administrative controls are mechanisms used by management to guarantee that all of the managerial policies are carried out and implemented in the leadership process (Roth, 1997). Another aspect of these controls includes management authorizing junior staff members to carry out business transactions on the

company's behalf. This process of authorization prevents defrauding or questionable activities by employees who may believe that management are lax in their duties and responsibilities (Rutherford & O'Fallon, 2007).

Small companies will be able to reduce any losses due to wastage or fictitious claims of deliveries because the delivered goods will be investigated and recorded against the original orders made by staff members (PriceWaterhouse, 1993). This process will lessen any costs resulting from bloated delivery lists and ghost deliveries (Galloway, 2003). Moreover, management will have the necessary information at hand to make immediate decisions, which will assist in cutting back on time and the wasting of resources. Therefore, over time, the operational costs of the small company will be steadily reduced based on planned business procedures because planning delineates time and money wastage (Sanders et al., 2008).

A small company that upholds and maintains good quality assurance will sustain customer loyalty, which will eventually lead to increased sales and reduced wastage and operational costs (Rutherford & O'Fallon, 2007). Internal controls foster a high level of authenticity, thus enabling all transactions to be properly authorized and legalized (Saunders, Hill & Faria, 2008). The result is a reduction in hidden costs resulting from disproportionate transactions. In addition, all of the internal control components work harmoniously to uphold accountability for assets and ensure authentic authorization to access the use of assets, periodic reconciliation between recorded assets on the books, and the physical assets that exists along with many other features that ensure that the assets are used for their intended purposes (Needles et al., 2005; PriceWaterhouse, 1993). Poor management and insufficient training of employees also contribute to the problem of internal control (Rutherford & O'Fallon, 2007). Employee turnover in small companies could be dealt with through the implementation of proper training and management programs (Alonzo, 2007). Proper training and management are important factors in retaining productive employees. (Coltman & Jagels, 2001).

CONCLUSION

The COSO internal control integrated framework addresses the operating effectiveness and efficiency, reliability of financial reporting, compliance with applicable laws and regulations, and the safeguarding of assets. Organizations and their internal control needs vary significantly by industry, size, purpose, management philosophy, diversity and complexity of operations, local culture and operating environment, and legal regulatory requirements. Although each company's internal control needs vary, the principles of internal control which are protection of assets, financial reporting reliability and compliance with applicable laws and regulations must exist for operational efficiency. (American Institute of Certified Public Accountants [AICPA], 2006; COSO, 1992).

Internal control activities have been used in various organizations since the implementation of the COSO (1992) internal control integrated framework to support best business practices, which ultimately aid the accountability, profitability, and survivability of companies. Some small companies are cash-based businesses and they often lack the impetus to conform to standardized internal control procedures such as the COSO internal control integrated framework.

Small companies are highly susceptible to mistakes spawning from the poor planning, organization, and control of procedures in their operations. Hence, management personnel are faced with the challenges of devising measures to promote operational efficiency and ascertain that all of the financial reporting goals are met. It is imperative for small companies to minimize their costs to make them more efficient and competitive. Internal control activities help to refine operational procedures, assign responsibilities, and prevent the loss or misappropriation of assets through pilferage and misuse. The survival of small companies will lead to much needed tax revenue, gainful employment, and a positive impact on society.

In summary, although small companies are faced with challenges to implement internal control systems because of various limitations such as costs, few employees and other constraints, it is worthwhile to note that effective internal controls can still be possible. Some internal control policies are basically best practices that come at little or no cost. With proper training these best practices can help small companies to achieve their objectives, increase profitability, return on investment and survivability.

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