

Some considerations on management internal control of stocks in the field of construction societies

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Abstract

Lately, dependence has become a reality between the need for information, the existence of a system that ensures their delivery and the development of society in general.

The system that can provide the required information is the information system, for which the technique and differentiated means are used depending on the type of system to be built, the level of development of the company from the economic and informational point of view.

The development of computerized electronic systems has made it possible to replace traditional primary documents with technical information carriers that fulfill both the role of primary documents and those of technical data support necessary for their further processing.

Improving inventory evidence leads to increased productivity growth, and the improvement of the information system is in fact the essential element for the transition to a new quality throughout the economic activity.

Keywords: control, management, stocks, accounting, information, decision

1. Literature review

In order to complete this paper I have used also internal and external literature sources composed by books, papers, articles written by some more or less known authors in the field. I have taken and developed some of their ideas in order to reach the purpose of this study, meaning to underline the importance of the internal audit also in the field of construction companies.

2. Research methodology

The qualitative research methodology was utilized in this study. The study started with a thorough analysis of the current internal audit methodology and practice. Next, best practices on the areas of problem were gathered and analyzed based on a literature review and on the author's previous papers concerning similar problems. Based on the results of the best practices review and considering also the objectives of the internal audit function, solutions to the problem were constructed.

3. The base of the research

A significant feature of inventories is that they go through a continuous cycle of acquisition, use in production and sales. In both cases, the producer and trader, the inventories and the cost of sales are significant both for the financial statements of synthesis and for the appreciation of the achieved performances.

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There are many risk factors that can affect stocks, including:

- the volume of procurement, production and sales transactions is generally high, thus increasing the risk of errors in accounts;
- there are always non-violet points with regard to inventory valuation, such as identification, sizing and allocation of indirect costs, accounting for residual products, estimation of deviations from standard costs, correct allocation of costs for the manufacture of complementary products, etc.
- special procedures are sometimes required to determine the quantity or value of inventories, such as the valuation of inventories by other experts;
- stocks are often stored in different places, creating difficulties both in controlling them to prevent theft or physical degradation and in accounting for stocks in transit;
- stocks are vulnerable to changes of the economic circumstances that may lead to a reduction in demand, sales and, therefore, the application of different treatments in such cases for their assessment;
- stocks may be subject to return contracts (for example, packaging).

4. The need for management internal control of stocks in the field of construction companies

In planning of the inventory management process, we need to be aware of the high risk of management's claims regarding the existence and stock valuation. As regarding the assets, the company management is motivated to overestimate inventories rather than underestimate them. Due to the non-existence of third parties in the case of production stocks, as is the case with construction companies, it is much easier to overestimate the value of stocks than in the case of other assets such as receivables, treasury, etc.

Preventive measures to mitigate the impact of risks on stock records at the disposal of the manager of the economic entity

In the case of a satisfactory managerial control system in operation, the following activities must be controlled:

- stock purchases;
- storage of stocks;
- exit from inventory management;
- determining the existence, physical integrity and rights of the stocks;
- inventory valuation.

Determining the moment when the transfer of rights to inventory from supplier to client is taking place is very important. There are situations in which stocks are transferred with or without property rights over them. From this point of view, we must appreciate the existence of effective controls on this type of transaction.

Depending on the nature of the stocks held in construction societies, the storage conditions, as well as the security conditions must be checked. The type of stock control storage as well as the security conditions will be different for company profile stocks.

In addition to direct control, in such cases, it is expected that restrictions on the exit of the respective assets will be in force - leaving the management on the basis of duly authorized documents. In addition, stockpiling should be done under appropriate conditions to prevent damage, destruction, and facilitate access and stock identification.

Control of exit from inventory management is often demonstrated by strict procedures (documentation) (which must be duly authorized) and assessment (in the case of the disposal of stocks that are difficult to sell for waste products, etc.).

Controlling the existence, physical integrity and rights of inventories requires the application of adequate physical inventory inspection procedures and conciliation of inventory results with accounting records followed by the investigation of inventory differences.

The existence of inventory differences (inventory pluses / minus) indicates a high risk. In addition to inventory availability, the inventory allows to determine the physical integrity of inventories and helps to identify exploitation rights on inventories.

Obtaining evidence of stock rights is more difficult, which leads to the need to apply additional control procedures. The basic principle retained for the valuation of inventories in the synthetic financial statements is to select the minimum cost between the cost and the net realizable value. Thus, all the controls exercised in this sphere of activity must ensure compliance with this principle. Particular attention should be paid to controlling deviations from the standard costs and the measures adopted to that end. Significant unplanned deviations may indicate a high control risk.

In order to verify management's statements in the financial statements about the existence and completeness of stock information, we must be able to choose a control strategy based on the company policy adopted to determine the amount of inventory held. The control strategies identified as possible in construction companies are the following:

- when inventories are accounted for by the permanent inventory method and the inventory is made close to the balance sheet date, the control strategy permits the control risk associated with inventory records to be relatively high;
- if inventories are determined quantitatively by inventory at the balance sheet date, the control strategy requires a predominant approach based on substantive procedures that does not test the control system applied to inventory accounting because it may be completely absent.

5. The determined internal control targets and risks in this area of activity

A major focus is on verifying the existence and evaluation of stocks, given the inherent risk associated with these two allegations. In general, the risk of not being detected is assessed at a low level for the existence and valuation of inventories, while for the rest of the allegations of inventories, the risk of not being detected may be at higher levels to averages.

In order to verify the initial balances, we must ensure that all adjustments agreed in the previous year on the occasion of the control have been recorded. Moreover, especially in situations where inventories are accounted for by the intermittent inventory method, we need to verify that all inventory records are kept up to date and kept up to date.

The analytical procedures applicable to stocks are very varied. An analysis of trends at branch or sector level may be essential for the development of the program of analytical procedures that will be applied to assess the analytical information of the company.

Verification of records in stock accounts is based on supporting documents. Where, at the balance sheet date, inventories are determined solely on the basis of the intermittent inventory, the appropriate detail tests shall consist of:

- verification of the physical existence of the stocks through inspection;
- investigating significant differences between physical inventory results and stock records.

If the quantity of stocks is determined by counting (weighing, etc.) at a date other than the end of the financial year, adjusted by reference to the accounting records for the period up to the quantitative verification, the detailed tests may be applied only to the remainder of the financial year between the time of the quantitative verification and the closure of the exercise.

Testing for compliance with the independence of procurement and sales exercises is important for identifying transactions that have taken place near the end of the financial year and for checking how they have been attributed to the year to which they relate.

When inventories are of significant importance in the context of the company's financial statements and stock inventory is not impossible, inventory observation is one of the major management responsibilities.

Where there is insufficient evidence of the existence of the initial balances or when the physical inventory at the end of the financial year can not be found and when it can not obtain sufficient and appropriate evidence by applying alternative control procedures, we have to abstain from issuing a decisive opinion that we should pass into the control report.

Applying this procedure allows us to provide evidence of management's assertions in the financial statements about the existence, completeness, valuation and rights, respectively obligations on stocks.

After inventory, the company uses inventory lists to compile the inventory report. All items after being counted, weighed, etc. are then evaluated, and the results are the basis for the bookkeeping corrections. Due to the importance of inventory lists together with the inventory register, we must ensure that the inventory lists faithfully the outcome of physical inspection, both in quantitative and in terms of value.

To determine if inventory lists faithfully present inventory results, you must:

- compare our own test results with those included in the inventory lists;
- to identify the lists drawn up when the inventory was assisted and to check their compliance with the inventory register;
- compare the results of the inventory with the accounting records, identify and ask for explanations regarding the differences noted;
- check the calculations for determining the value of inventory items.

Verifying inventory valuation involves determining the cost of inventories and their net realizable value, as well as comparing the two values to keep the minimum in the synthetic financial statements.

In the case of stocks of finished products, finished products and semi-finished products, the cost has to be checked in the light of cost accounting. The calculation system used by the entity is assessed in principle during the interim control when applying tests on costing methods of production. If inventories in production are valued at standard cost, the variations recorded against it should be analyzed.

International Accounting Standards (in this case IAS 2) require that inventories be reflected in the balance sheet at net realizable value if it is lower than cost. The estimation of the net realizable value implies the use of accounting estimates, which means that we have to take into consideration the provisions of the accounting estimates that imply:

- analyzing and checking the estimation methods applied by management;
- the use of independent estimates;
- continuous analysis and review of further developments.

In the case of inventories valued at net realizable value, the method of calculation and net realization should be checked. In some situations, the starting point is the current value or the contract sale price, corrected for the sales / realization costs involved. In other situations, calculation formulas that take into account age, previous changes, and expected future changes to those stocks may be used. We need to examine the data and assumptions underlying the formulation of the estimates, verify the calculations, analyze the previous evolution of the stock, and verify that the estimates are properly approved by the management.

Regarding the inherent risk assessment through the under-valuation of inventory book value adjustments, we must apply the substantive procedures that allow us to identify the needs for further adjusting the inventory book value. IAS 2 retains the following situations in which the adjustment of inventories may be required: lowering the sales price; physical damage; perimeters; the decision to sell at a loss; purchase or production errors.

The specific procedures normally applied consist of:

- analysis of sales made after the balance sheet date;
- finding obsolete stocks during assisted inventory
- analysis of stocks held in relation to the scheduled turnover to determine the excess stocks;
- discussions with the company's management, sales and production staff;
- analysis of the minutes drawn up during the meetings of the Executive Board, etc.

If the assertions made in the financial statements about the value of inventories are related to complicated technical issues, the assistance of technical experts in the field may be required.

When stocks are deposited with third parties, we must obtain evidence of stock availability through direct communication with custodians. The application of this procedure may provide sufficient evidence, unless the amounts involved are not material in relation to the total assets or current assets. In such circumstances, we have to decide on the following procedures:

- assessing the integrity and independence of the custodian;
- assisting with the inventory of stocks in custody;
- obtaining and analyzing the report of a specialized person, if the latter has carried out the physical inspection of the stocks under custody;
- creditors' confirmation of warranties lodged as collateral for contracted loans.

The application of this procedure provides evidence of the assertions contained in the financial statements regarding the rights and obligations on the stocks. Similarly, the procedure may allow evidence to be provided of the completeness of inventory records if custodians confirm a quantity of stocks greater than that identified in the company's accounts.

Confirmation of stocks by the custodian does not provide any evidence of the value of the stored stocks, as the custodian does not have legal competence in this area.

There are situations in which companies can hold stocks that belong to their customers at their request, after the sale has taken place. Another possible situation is the purchase of stocks with either a return or a payment obligation if there is a subsequent sale. In this way, management will be required to separate the inventories of commodity stocks during inventory. In addition, a written confirmation of stock ownership is usually required.

In the reverse situation, management is asked to confirm the inventory of the company, but it is "recorded" to customers. For such cases, we need to look at the contracts we have agreed with third parties and ask them to confirm the quantity of "recorded" stocks.

In another possible scenario, stocks can be used as collateral for contracting credits. In this regard, we need to obtain information / explanations from the management on the existence of such credit agreements and verify the publication of additional relevant information in the notes to the financial statements.

Also, we must not ignore the creative accounting techniques applied at the stock level. Thus, recording a significant sales volume close to the end of the financial year to a customer who appears not to require the immediate delivery of the goods may hide an attempt to lower inventories and increase liquidity, leading to an erroneous picture of the calculated economic indicators based on this accounting information. Often, such techniques are followed by the acquisitions in the period immediately following the end of the financial year. Such transactions must be accounted for according to their economic substance: secured stock loans.

Through this procedure, we have the ability to provide proof of management's assertions in the financial statements about the rights and obligations on stocks, as well as the presentation of stock information in the annual accounts.

We also need to ensure that the main stock categories have been identified and grouped correctly in the financial statements. In addition, the notes to the balance sheet must provide additional information on: the methods used to determine the costs; stocks used as collateral; the existence of major procurement commitments.

Talks with the company's management are a commonly used procedure for determining whether there are constraints on future stock purchases based on third-party conventions. In the event that there are such restrictions, we must examine the contracts concluded and evaluate the honesty of the accounting and reports prepared by the company to the extent that significant losses are recorded in the acquisition contracts, they should be recognized in the financial statements together with the disclosure in the notes additional information on the circumstances that led to such an evolution.

The evidence regarding the disclosure of information in the financial statements is obtained through the substantive procedures described above. Further evidence can be obtained, as necessary, by consulting and reviewing the minutes of the board meetings and discussions with the company's management. On the basis of the evidence obtained and the comparison of the financial statements prepared with the requirements of the relevant presentation and publication standards, we have the possibility to determine the honesty of the presentation of the stocks in the financial statements.

6. Some suggested solutions

Lately, the dependence between the need for information, the existence of a system to ensure their delivery and the development of society in general has become a reality.

The system that can provide the required information is the information system, for which the technique and differentiated means are used depending on the type of system to be built, the level of development of the company from the economic and informational point of view.

The development of computerized electronic systems has made it possible to replace traditional primary documents with technical information carriers that fulfill both the role of primary documents and those of technical data support necessary for their further processing.

Construction company's management should aim at implementing modern and up-to-date computer systems, namely choosing a multiuser database management system, meaning multiple users use the same remote database at the same time, resulting in a good use of resources server and memory savings, thanks to the unique database memory.

The facilities provided by the distributed databases provide the design of computer systems characterized by:

- the existence of a distributed database ensures the homogeneous grouping of all system data projected for shared use by all the functional compartments of the unit;
- ensuring an interaction between the creation and exploitation processes of the distributed database, allowing dynamic collaboration between its own applications and the link with other external systems;
- the availability of data in the current form required by the functional compartments and their operational transmission for the constitution of information support in decision-making.

7. Conclusion

Improving inventory evidence leads to increased productivity growth, and the improvement of the information system is in fact the essential element for the transition to a new quality throughout the economic activity.

As a result of the study I consider that the main functions and characteristics that a manager has to follow for correct inventory evidence in a construction company are:

- inventory tracking at multiple levels: at unit / subunit level with own balance; at the management level, with the possibility of defining multi-level management hierarchies; in some cases, management may choose to track physical location;
- transparent tracking of multiple inventory criteria: Different article codes need not be defined to track the same article entered into stock with different prices, the system solving transparently the management for each price; it is possible to track inventory with lots with distinct evidence on each, it is possible to track a serial number of stocks
- automatic cost calculation at management outputs: calculation method is selectable at management level (FIFO, LIFO, CMP set price with update after each move);
- real-time information and reports: stock lists at different levels, inventory balance, stock records;
- transfers between management, inventories and stock adjustments: transfers between administrations with automatic generation of appropriate operations according to predefined rules; in the transfer between administrations in two subunits, each with its own balance, the accounting records required in the records of each sub-unit are transparently generated; the system has inventory capabilities including sample inventory by the ABC method; pluses and gaps are controlled by documents, with the specification of the causes.

Following the study, I found that the inventory management system of construction companies should allow accurate inventory records by performing the following functions:

- the existence of a unitary inventory of stock items;
- access by authorized persons to all necessary information. For example, the ability to set in real time the stock for an item in all the company's warehouses (headquarters, bases, units);
- all internal transfers are authorized only if they are in the budget. It is recommended that the degree of freedom from the budget should be at the recommendation / warning level and not at indicative / imperative level. Thus, if it does not fit into the budget, the system will allow for the transaction but will warn about overcoming budgetary provisions;
- the same initiation, approval and execution procedure for all sub-units on the same level;
- unitary, scientific, annual need determination;
- unitary, scientific, operative stock insurance procedure;
- unitary, scientific, periodical inventory management;
- the possibility of keeping records up to the storage position within the management;
- the possibility of requiring certain articles to be stored only in certain administrations or locations;
- the ability to restrict access to transactions only to authorized persons, by group of articles, for query / modification as appropriate;
- keep track of the history of the changes made to the inventory database, as well as of the persons who performed them;
- drafting stock value reports, by stock structures;

- the evolution of the stock structure over time based on framework contracts and the unit deliveries over the past 3-5 years;

Regarding the main objectives of stock management control at construction companies I believe that it should concern the following aspects:

- stocks are in good condition and are owned by the company;
- the costs of bringing inventories to the current condition and location were determined correctly;
- stocks were valued at the lower of cost and net realizable value, and adjustments were made to reflect the current state of inventories;
- all stocks are accounted for in the accounts;
- inventory valuation policies are adequately disclosed in the financial statements;
- the principle of independent exercises is respected;
- expenditures registered (materials, raw materials, labor, indirect costs etc.) are included in the production cost;
- the cost of production (materials, raw materials, labor, indirect costs, etc.) was correctly calculated;
- production costs were appropriately allocated,
- all the costs involved in production have been properly identified and recorded in the accounts;
- the cost of production affects the corresponding financial year.

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