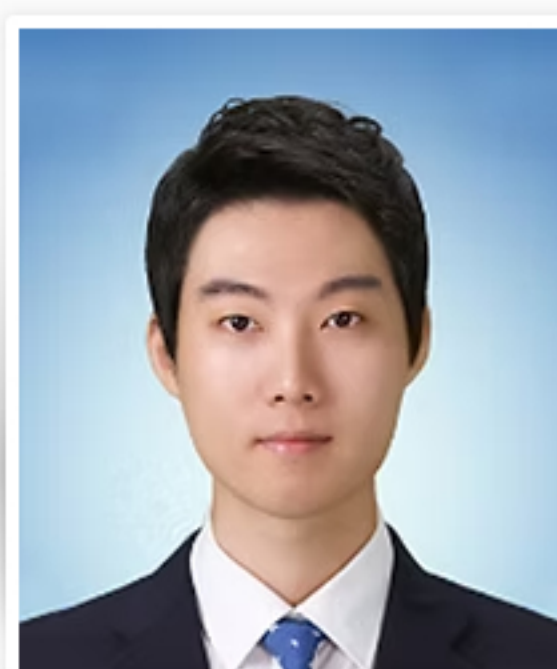


## Control is a burden? Internal Control that add values to Enterprise



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Korean Financial Supervisory Service recently announced six checkpoints that companies must follow to prevent embezzlement: 1)Approval procedures (account opening, withdrawal, transfer, and journal entry), 2)Separation of incompatible positions (ex: treasury & accounting), 3)Periodic job rotation, 4)Frequent balance check of bank account, 5)Separate storage of bank books, corporate cards, & seals and 6)Independent internal audit system. In reaction to the announcement, many companies have developed and elaborated existing control activities. However, it is obvious that top management and employees have felt a lot of discomfort from these "additional" control activities. Main reason is because there has been already excessive amount of investment due to the K-SOX implementation. It is also considered as a "burden" or "pain" in terms of cost-benefit perspective. In fact, it requires a lot of investment and control owners' time & energy to upgrade existing control activities including, separating duties into several people, creating systematical verification and approval stages, and hiring experts to monitor these procedures. Many process or control owners may feel, 'I'm too busy doing my job, and they're bothering me with every little thing,' or 'I never commit fraud, nonetheless they keep bothering me.'

However, we need to re-think this matter from "prevention" perspective. A single fraud incident can significantly reduce a company's reputation or value. Although traffic accidents do not happen every day, we do not complain about our monthly premium considering its coverage for our potential loss. Some people may oppose to this statement in that they are good at driving and will not face any accident, but it is not a reasonable decision making under uncertainty. Elaborating internal control system and possessing dedicated team is similar to the "premium" we pay to minimize potential loss we might face from the road.

Academic studies on internal control have demonstrated negative relationship between companies with solid internal control systems and the probability of occupational fraud occurrence: accounting fraud, corruption, and asset misappropriation. Quality of financial statements is improved with solid internal controls by reducing the number of errors in financial statement preparation and possibility of restatements. It also reduces opportunities for management to smooth income to achieve their personal performance goals. These studies show that a well-run internal control system is very effective in preventing the spread of corruption by management and its employees, as well as suppressing the possibility of top management's fraudulent or opportunistic behaviors. In a long term, it leads improved investor confidence, an increase in the company's stock price or credit rating, and a corresponding reduction in interest expenses, which produces "visible" financial impact."

There are also studies that show that internal control improves the operational side increasing efficiency. In order to operate control activities, it is essential to upgrade "systems" in various aspects, which leads more reasonable investment decisions. For example, inventory control is a process of ensuring the right amount of supply is available and the practices ensures to meet customer demand and delivers and financial elasticity. If inventory management system is designed to reflect real-time data from purchases, reorders, shipping, warehousing, storage, receiving and loss prevention, each step of tasks can be standardized to avoid wasted time and achieve loss prevention. Internal control ensures that each step of procedures are set in place in system and suggest for further upgrades for efficient control operation. A company can improve process by prioritizing its resources with a basis of solid internal control with system environment.

Internal controls can add value to its organization with positive impacts. It is important to operate control activities with a mindset that it can "create values" by improving process in a better way, discarding the negative stereotype that it is just a "burden". Participation of all employees, or control owners, it is important to "substantially" operate internal control system, not "mechanically" meeting minimum requirements of regulations.

*"Whether you are a public official or a businessman, if your goal is to make illegal profit, your task will inevitably fall into inefficiency, the unit price of products will rise, and you will inevitably lose competitiveness. My goal is to make Hyundai a company with integrity not a biggest company". "If we compete with integrity, we can win not only in Korea but also in the world with our biggest strength: trust."*

- Chung Ju-young, Founder of Hyundai Groups, in a special lecture for Hyundai Group executives in 1983

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