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The importance of robust controls in an uncertain economic environment

Internal controls are the processes and procedures used by management to achieve their strategic objectives. Internal controls are not just financial, but exist in all areas of the business, including IT, marketing and sales, people and compliance. When doubts are raised about the sustainability of future economic growth, it is critical for organisations to ensure that their internal controls are strong and that risks are managed.

What impact does economic uncertainty have on internal controls?

During periods of economic growth organisations are under less pressure to achieve efficiencies and maintain tight internal controls. However, when the economy slows or during a so-called 'credit crunch', the importance of such controls increases. The better the internal control environment in an organisation, the more likely it is to trade successfully through any economic downturn.

So internal controls will help a business through an economic crisis?

Not necessarily. If internal controls are not a key part of the business, they are little or no use. One recent example of this is Société Générale, which suffered a loss of £3.7 billion apparently as a result of fraudulent trading by a rogue trader who managed to circumvent controls. Preliminary reports seem to show that while Société Générale had a risk control framework in place, it was merely a 'checkbox' system with compliance officers rarely going beyond routine checks. In fact, the early reports found that the bank missed 75 warning signs, some from as far back as June 2006, that should have alerted managers to unauthorised actions taking place.

How do risks relate to internal controls?

Risks are not necessarily bad, as without risks there are no opportunities. However, depending on the organisation's appetite for risk, certain risks may need to be managed. Therefore, once risks have been identified, the management team need to identify appropriate control solutions - although independent advice will always be useful.

How are risks affected during periods of economic uncertainty?

The nature and extent of risks facing an organisation can change during periods of economic uncertainty

or decline. Tighter margins increase pressure to achieve efficient processes. At the same time, however, internal focus on these processes may be weakened. For example, when the economy is uncertain, individuals working in the business may feel insecure about their own job security. They may become distracted, with a potential adverse impact on the quality of their work.

What other repercussions are there from economic uncertainty?

Business plans and budgets are developed based on certain assumptions about economic growth, future sales, finance costs, etc. If projected growth figures fall for the economy as a whole or other factors change (such as the availability or cost of finance), an organisation's own business plans and budgets can be affected. It is important to check that business plans and budgets being used by management to take business decisions remain appropriate.

What do I need to do?

It is vital that all firms independently review their risks and internal controls on a regular basis - especially considering the uncertain economic environment. Moore Stephens offer an Internal Controls Healthcheck to do just that - for further information contact Anjit Ahuja on 020 7334 9191 or anjit.ahuja@moorestephens.com.

Over the coming months we will examine each of the five key internal controls (finance, technology, people, sales and marketing, and compliance) in turn, providing checklists and best practice advice for each.

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