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Assessment of the internal financial control system's modification results

Abstract. Introduction. Nowadays, in the rapidly changing economic environment, the structure and element correlation in the internal financial control systems cannot remain static. **Purpose.** Our target was to work out a set of indicators to measure the effect of internal financial control systems' modification and develop quality criteria in order to assess the professional performance of internal financial control specialists.

Results. When evaluating a modified functional structure of the internal financial control, we propose to use a set of qualitative and quantitative indicators, including: adequacy and realism of expectations of a company's management and owners; a number of reduced tax claims during the reported period; a number of financial audits and number of revealed and prevented financial risks per a single controller.

Conclusion. The suggested criteria can be indicators of the system of internal financial control modification's efficiency in conditions of new economic development and management.

Keywords: Internal Financial Control System; Control Procedures; Financial Control; Measurement Criterion; Management System

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Оцінка результатів модифікації системи внутрішнього фінансового контролю

Анотація. Мета статті – розробка комплексу показників, що дозволяють оцінити результати модифікації моделі внутрішнього фінансового контролю. Якісні критерії оцінки діяльності фахівців внутрішнього фінансового контролю повинні бути доповнені кількісними.

При оцінці модифікованої організаційно-функціональної структури внутрішнього фінансового контролю нами пропонується використовувати сукупність якісних і кількісних показників, серед яких: адекватність очікуванням менеджменту та власників компанії; зменшення числа податкових претензій поточного звітного періоду; кількість фінансових перевірок і величина виявлених і знешкоджених фінансових ризиків, розрахованих на одного контролера.

Ключові слова: система внутрішнього контролю; контрольні процедури; фінансовий контроль; критерії оцінки; система управління підприємством.

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Оценка результатов модификации системы внутреннего финансового контроля

Аннотация. Цель статьи – разработка комплекса показателей, позволяющих оценить результаты модификации модели внутреннего финансового контроля. Качественные критерии оценки деятельности специалистов внутреннего финансового контроля должны быть дополнены количественными измерителями.

При оценке модифицированной организационно-функциональной структуры внутреннего финансового контроля нами предлагается использовать совокупность качественных и количественных показателей, среди которых: адекватность ожиданиям менеджмента и собственников компании; уменьшение числа налоговых претензий текущего отчетного периода; количество финансовых проверок и величина обнаруженных и обезвреженных финансовых рисков в расчете на одного контролера.

Ключевые слова: система внутреннего контроля; контрольные процедуры; финансовый контроль; критерии оценки; система управления предприятием.

1. Introduction. In the USA, the adopted Sarbanes-Oxley Act on 30th July 2002, strengthens the requirements to financial reporting. The main objectives of the law were:

- control over correctness and accuracy provided in the financial statements data on the situation of the company;
- ensuring compliance with requirements of normative documents on accounting;
- tracking the effectiveness of the internal control process.

Sarbanes-Oxley Act requires that company's management implements and operates an internal control system over reliability of financial reporting and measurement of such performance efficiency. The implementation of the internal control system in accordance with the requirements of the Sarbanes-Oxley Act specifies the necessity to measure the efficiency of control procedures and the management of auditions.

On the 1st of January 2013, the Federal law No. 402-FZ «On accounting» came into its legal force in Russia. Its task is to make economic entities implement internal financial control

for all facts of their economic performance that is supposed to increase the reliability and accuracy of the financial accounting statements.

Effectively functioning system of internal financial control is designed to increase the level of confidence in operational information, which is the basis of successful management of economic entities. Thus, according to V. V. Ilyin and V. N. Zhukov (2015), «the internal control system is at the same time a function of financial management of companies, economic institution, and resource of information» [1, p. 3]. For an enterprise, the system of internal financial control is an important competitive advantage that allows on the basis of timely and accurate data to make managerial decisions in a more efficient manner and to respond to changes in the external environment.

2. Statement of the problem. At the majority of large enterprises, the internal control systems have been operating for a number of years. Together with changing business environ-

ment under the influence of various external and internal factors, it is always necessary to modify the existing services. And on this stage, there appears the problem of internal control system's efficiency measurement.

3. Brief literature review. In the Russian Federation, financial and revenue authorities in their evaluation of internal financial controls' efficiency use the COSO model, which is widely accepted at the international level.

However, according to A. A. Bolshov (2010), «the issues of the influence of corporate financial control system on the performance of an enterprise is not sufficiently studied in works of foreign and Russian scientists, thus, the efficiency of an enterprise cannot be expressed in financial terms» [2, p. 5].

Significant contribution to the development and scientific substantiation of the enterprise's performance indicators system was made by some foreign scientists, such as R. Kaplan and D. Norton (2005) [3], K. Savares (2001) [4], D. Parmenter (2007) [5], D. Han (1997) [6]. Among the Russian researchers of measurement of internal control efficiency, one should name V. D. Andreev and S. V. Cheremshanov (2004) [7], V. V. Burtsev (2005) [8] and others.

4. The purpose of the article is to develop a set of indicators to assess the results of the modified model of internal financial control system.

5. Results. According to the carried out research, to increase the economic feasibility and efficiency of individual control procedures and the system of internal financial control in general, we should gradually transform the system which only states facts into the one dealing at the same time with both research and analysis [9, p. 50].

V. I. Evdoshchak and Yu. A. Manchinskaya (2015) suggest to reconstruct the system of enterprises' internal control on the actuarial basis of accounting with the priority of a new innovative system of accounts, the latter should take into consideration the effect of changes in internal and external economic environment in order to provide a business entity with the appropriate level of management [10].

The efficiency of an internal financial control system depends on a range of various internal and external factors. One of the most important factors is the scientifically based approach to the interaction of functional elements in the internal financial supervision. From a methodological viewpoint, this means that development of control procedures should be based on scientific principles of effective monitoring and successful practices of implementation towards systems of financial management.

According to Y. A. Pavlova (2010), «the choice of internal control forms depends from the organizational structure complexity; legal form of entity; types and scope of business performance; feasibility of supervision in different aspects of the activity; attitude of the management to controlling measures» [11, p. 42].

The method of effective functioning of an internal financial control system should be constructed as a union of theoretical developments of domestic and foreign scientific schools together with legislative, managerial and methodological rules of the efficient control procedures implementation into the financial and economic performance of business entities. The completeness and efficiency of these principles implementation into practical operation depends on several factors, among the most important ones are: mandatory (the system of state regulation of economic and financial relations) and sector (branch) factors.

The bigger the company, the more functions its departments have to fulfil. Whereas in small companies there are, as a rule, special internal audit departments, where relatively independent functions and objectives are clearly defined for groups of controllers. These departments are focused mainly on the accounting process. According to V. V. Alekseeva (2013), «the accounting process is under the major influence of the degree of mechanization and automation, specific features of economic performance of an enterprise, and the book-maintenance form and other factors» [12, p. 167].

To understand the efficiency of the internal financial control at enterprises, we shall apply the system principles of

interrelations between control procedures over the companies' cash flow and the results for production control, while the latter is focused on the evaluation of the effectiveness of stocks and costs rationing, their maintenance and economic usage, the ratio of costs and benefits, correlation of outflow and inflow of funds, the balance of receivables and payables [13, p. 33].

It is necessary to develop new basic control procedures in the spheres of settlement and payment operations for economic entities to improve the efficiency of control procedures.

The most urgent changes in procedures are required for the following sections [14, p. 284]:

- control over financial results of economic performance;
- control over assets and finances;
- control over the use of the capital;
- control of business activity, financial and economic productivity of single structural business units.

In its economic content and the nature of relationships, internal financial control system varies according to state economic, financial, social and political environment. Therefore, the operation of the elements of the internal financial control system as well as the application of certain control procedures are very difficult for qualitative measurement in the sense their performance and strategic planning.

It is possible to plan the expected result only in respect of the controlled object's state change, but not specific test procedures, as definite are the subject, the object and the parameters of desired to achieve the objectives of the controlling.

O. V. Smetanko (2014) suggests that in the process of finding and developing key performance indicators, the head of internal control service should consider the following enterprise's features:

1) the key performance indicators are reasonable to be introduced in those companies where internal audit is focuses on the system of internal control and accounting, that is, where each approach is used in the verification process;

2) indicators of value-oriented management system should be introduced at the enterprises, where in the system of corporate management there exist risk management targeted to control key business processes [15, p. 136].

It is difficult to measure or evaluate the internal financial control of industrial enterprises, as many operational processes are determined by the financial interests of the owners, so, the audit of financial performance is organized in a special way, focusing on internal targets and considering features of creation, increment and use of money value.

In order to define the efficiency of internal financial control system, it is necessary to use a set of interrelated qualitative and quantitative indicators to evaluate not only the control procedure, but the whole cycle of the control actions towards every single test object, for example - the movements of receivables and payables.

In this case, the reduction of this type of debt can be viewed upon as an estimate of the performance of economic services of the enterprise, but also the assessment of the effectiveness of internal financial control, evidence of their high connectivity within the experts' teams in economic services and the management of the company

Qualitative criteria for measuring the performance of specialists of internal financial control requirements shall to be supplemented with quantitative measures. Especially important such instruments of measurement are for the restructuring of the enterprise management system, modification of its functional services depending on the changes in the external economic environment, legislation, area expansion, involving the circulation of foreign capital and for other significant reasons. In large companies, as a rule, there is a quality development program for performance of internal financial control team. The quality improvement is obviously understood by us as a set of interrelated among them the arrangements to assess the effectiveness of applicable control procedures and on this basis compare the cost of control with its efficiency. By the fact of how small or how big such a gap can be judged on the quality of functioning of internal financial control system.

Into the list of performance efficiency indicators of the functioning of internal financial control, we should include, for example, the following indicators:

- reduction of the number of tax claims during the reported period compared with corresponding periods before;
- number of performed financial audits where there were detected and removed financial risks per one controller;
- the percentage of implemented recommendations from controlling team, that allowed to increase the financial profitability of the capital;
- direct reduction in costs/economy of the recommendations of controllers implementing during the reported period.

In this list of performance indicators, we consider two as the most significant:

1. The decrease in the number of tax claims during the reported period compared with previous periods;

2. The number of financial audits and the amount of detected and removed financial risks per a single controller.

It is quite simple to receive the value of the first performance indicator, as such statistics are conducted by the head of the internal financial control team in every company.

In most cases, only the record of the tax audits results is reported, but it is necessary to keep a special journal of records of the reasons for financial (tax) sanctions, the forecast value of tax bases according to changing tax regulations and options, the accounting policies of the company without the possibility of tax risks.

The second indicator - the number of conducted financial audits and the amount of identified and neutralized financial risks per controller (Efk) (EPC) is possible to calculate by the formula:

$$Efk = \frac{\sum FA(W + O)}{N}, \quad (1)$$

where Efk is general effect of financial control procedures;

FA - financial audits;

W - revealed financial risks;

O - cleared financial risks;

N - number of participants in the control procedure for audition of a certain cash flow.

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Tab. 1: The dynamics of changes of financial control systems' modification efficiency (on the example of the «Kursk Electrical Apparatus Plant»)

Indicators	Before the modification 2013	After the modification 2014
1. Amount of receivables, thousands of rubles	37 378	30 346
2. Number of debtors	21	18
2. Payable amount, thousands of rubles	55 387	50 642
3. Number of creditors	41	36
4. Amount of fines after the cameral tax audit, thousands of rubles	12	8
5. Amount of fines after the field tax audit, thousands of rubles	15	4
6. Amount of additional tax charges after the cameral tax audit, thousands of rubles	23	10
7. Amount of the tax assessments after the field tax audit, thousands of rubles	45	6
8. General effect of financial control procedures	19	31

Source: Authors' elaboration

The suggested method of measurement of internal financial control systems' modification efficiency was applied to evaluate the named criteria of internal financial control at the «Kursk Electrical Apparatus Plant» (Table 1).

The dynamics of indicators displays that in this case the suggested modification was efficient for the internal financial control.

6. Conclusions. When evaluating the performance of the modified enterprise's structure of internal financial control, we suggest using a set of qualitative and quantitative indicators. The suggested criteria can be used as indicators of the system of internal financial control modification in the new conditions of economic development and management.

Along with procedures of regular efficiency measurement in the performance of the internal financial control system for current financial transactions, there should be implemented a system of evaluation of the adequacy of control procedures in correlation with changing economic and legislative environment of the economic space and the law (a criterion of qualitative measurement). This is the task to be supervised by the assistant of the head of internal financial control department.

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