

Approaches to the Performance of Economic Agent Internal Control

Irina A. Slabinskaya, Iuliia A. Tkachenko, Denis V. Slabinskiy and Aleksandr A. Mitrokhin
Belgorod State Technological University Named after V.G. Shukhov,
Kostyukova Street 46, 308012 Belgorod, Russia

Abstract: Improvement of internal control system is an ongoing process of substantiation and implementation of the most efficient forms, methods, means and ways of its creation and development; rationalization of its individual positions and sides, control and identifying of shortcomings on the basis of continuous monitoring and evaluation of internal control system compliance to internal and external conditions of economic agent functioning. High-quality level of formalization of economic agent activity is required for the efficient work of internal control. The larger economic agent and more complex its structure, the more significant impact on the result of its activity has the organizational framework. Activity formalization starts with the approval of the organizational framework of economic agent. Organizational framework is a security for efficient functions distribution between business subdivisions. Otherwise functional relations in the vertical control are built incorrectly; there are overlaps and gaps in the implementation of certain functions by services, inability to assign the responsibility for the result to specific persons. Performance of quality control is conducted by the analysis of economy agent management actions with the purpose of establishment and maintenance of the internal control. It is necessary to mention that internal control is an important part of management process for any manager.

Key words: Internal control, efficiency, control environment, monitoring, performance

INTRODUCTION

Performance level of the internal control system is diversified for different economic agents (Tkachenko, 2007). Research of the factors, both positive and negative, influencing the level of effectiveness of internal control system have not been conducted so far. It should be noted that other economic agents are unfamiliar with the positive experience of internal control system arrangement gained by the number of Russian companies. Internal control system formed in the company does not always provide necessary effectiveness and reliability (Tkachenko, 2014b). Improvement of internal control system is an ongoing process of substantiation and implementation of the most efficient forms, methods, means and ways of its creation and development. And internal control system can be characterized as a formal service in the majority of economic agents (Tkachenko, 2014a).

MATERIALS AND METHODS

Main part: The purpose of internal control system is timely prevention of irrational or improper actions as well

as errors when processing the information of economic agent. Regarding the situation the following moments need to be emphasized:

- Internal control system should be developed and must operate strictly within the approved organizational framework and functions fulfilled by subdivisions
- In the process of control strategy development, it must be taken into account that control implementation is pretty much limited with physiological capabilities of the human body and the possibilities of the information infrastructure of economic agent
- Inadequate increase of the volume of controlled parameters leads to the loss of control over the strategically important control objects such as marketing strategy, borrowings strategy, restructuring, information infrastructure development
- Parameters controlled by the business center should correspond to the significance criteria suitable for this responsibility center. Significance criteria should be used by the analysts of economic agent in practical activity for limitation of the controlled parameters quantity (Slabinskaya *et al.*, 2014a)

Internal control function can be implemented by several means and that is why it is not necessary to create separate subdivision, department or service in order to enjoy the benefits provided to economic agent by the effective internal control (Slabinskaya *et al.*, 2014b).

At the same time, an external consultant or specialized company can implement the function of the internal control subject to non-admittance of the conflict of inner and outer interests. Three basic approaches to internal control function construction can be distinguished:

- Creation of own Internal Control Service if economic agent possess all necessary financial resources
- Outsourcing-implementation of the internal control function is completely transferred to specialized company (external consultant)
- Co-sourcing-Internal Control Service is created within economic agent; experts of specialized company (external consultants) having appropriate knowledge, experience, qualifications are also engaged in tasks fulfillment

Specified approaches can be applied in economic agents in different combinations and variations. When selecting from possible options the pros and cons of each should be evaluated. Organization, purposes and functions of the internal control are determined by the management and (or) owner of economic agent depending on the form of incorporation and the existing system of governance, maintenance, specificity and scale of operations, internal control condition and the level of financial and economic activity.

Service (department) of internal control formation should be started with the headhunting of a manager of the service. The most favourable variant is a situation when Internal Control Service manager is functionally subordinated to the board of directors and administratively to the general director of the organization. If there is no board of directors or similar body in economic agent, then Internal Control Service has to be both functionally and administratively subordinated to the senior officer of the organization. Theoretically, the Internal Control Service accounts to top management and is granted relief from other managerial accountability. Some of the internal documents regulating the activities of the Internal Control Service include:

- Internal Control Service regulation (determines the mission, goals and objectives, responsibilities and authorities)

- Internal Control Service Guideline (contains the issues for work organization of the service and interaction with other subdivisions)
- Corporate standards (contain standard forms and methods of audits and other tasks conducting)
- Job description for employees of the Internal Control Service

If company is rather advanced in matters of internal control and is guided by the recommendations of international standards of internal audit, procedures of quality assessment and activity efficiency of the internal control could be published as a separate document.

Quantity of Internal Control Service employees should depend on the tasks, control environment condition and different kinds of risks exposure. Quantity is determined primarily based on the number of subdivisions and business processes, existing in economic agent and temporary expenses for control and audit conducted for each of them. Activity performance of the internal control is determined by the following criteria.

Specific status of the Internal Control Service in economic agent structure and influence of this status on the ability of a service to be objective. Theoretically, the Internal Control Service accounts to top management and is granted relief from other managerial accountability. Practically, the Internal Control Service is most often accountable to the President, general or financial director and rarely if ever to the board of directors.

Functions volume, i.e., the nature and the volume of orders carried out by the Internal Control Service. The responsibility for drawing up of the inspections schedule, determining the composition of the inspectors, preparation of an audit report, reports including on the work done, compiling guidance materials, conducting expository workshops are assigned to the manager of the Internal Control Service. Specific list of tasks, status, structure and other features of service are established by the independently developed Internal Control Service Regulation.

Professional competence: Internal inspectors should have appropriate education, skills and experience. If the Internal Control Service includes a variety of subdivisions, then it usually has economists, lawyers, accountants. If economic agent is engaged in a specific activity then the service has experts and specialists in different areas: appraisers, engineers, geologists, logisticians, programmers.

Due professional diligence (if the internal control is planned in a proper manner, controlled and

documented, the availability of adequate audit guides, working programs and working papers) (Slabinskaya *et al.*, 2014b).

The choice of the form of economic agent internal control depends on the complexity of the organizational and legal structures, forms and scope of activities, practicability of the coverage of various aspects of the activity by control, stance of management on control and financial solvency.

Let's determine the range of actions ensuring the efficiency of the internal control in terms of its individual elements. Firstly, the influence of control environment on the quality of internal control which reflects working conditions of internal control elements needs to be mentioned. It is determined by the internal factors (organizational structure, level of procedures formalization, administrative philosophy of management, resource base) as well as external factors. High-quality level of economic agent activity formalization is required for the efficient work of the internal control. Activity formalization starts with the approval of organizational structure of economic agent (Tkachenko and Slabinskaya, 2014).

The next integral part of the control environment is the documents regulating the activities of individual specialists form other subdivisions, namely regulations, standards and procedures.

Quality control improvement is also carried out by the analysis of management activity of economic agent with the purpose of establishment and maintenance of the internal control. It is necessary to mention that internal control is an important part of management process for any manager. Efficiency of manager's activity in this direction is due to the factor how deeply the manager feels the process of control to what extent he and his subordinates possess control techniques, what priority have the tasks associated with the statement and operation of the internal control in economic agent. Any component of the internal control is finally a vision peculiar to economic agent manager of the construction features for control system (Chizhova *et al.*, 2014).

Within frames of economic agent activity all types of control, intended for fraud risk prevention and having at least a minimal chance to take a significant effect on the activity should be evaluated. Efficient program of fraud prevention includes the following key components: code of conduct, hotline for employees who have witnessed a fraud, investigation and action upon fraud detection, supervision carried out by the Internal Control Service and the board of directors. One more component of the internal control is risk assessment. In order to conduct an efficient control economic agent should set a goal and

identify the risks that may affect the achievement of goals. Top management of economic agent has to consider all consequences of the appropriate risks which would block the achievement of goals and create a foundation for risk management. The process of risk determination and analysis is continuous. Basic elements of risk assessment are: business-risk assessment, risk analysis, management of changes, inherent risks and risks of illegal actions. Management of the organization can apply to risks the following combination of procedures:

- Conduction annual risks assessment by the Internal Control Service, conducting risks assessment at level of business center in the form of independent assessment
- Assignment of the one of top management executives to be responsible for conducting independent risks assessment
- Conduction the work on risk assessment by the Internal Control Service
- Regular meetings of top management executives to discuss main business risks

Control procedures should be fulfilled at all levels of organization and in all business centers. Control events should include: approval, authorization and verification of transactions, analysis of activity efficiency, soundness of assets and allocation of responsibilities.

RESULTS AND DISCUSSION

Control events must be aimed to achievement of specific purposes of data treatment as ensuring of completeness and accuracy of data treatment.

Component of internal control "Information and networks (communications)" includes systems which promote identification, collection and exchange of information in the form and period of time that allow personnel to fulfill their duties properly. "Information and networks" component should charge all other components of the internal control thus methods which ensure and distribute information must be developed. It is necessary to mention that information formed for internal control should be sufficient but not excessive. Excessive information requires not only funds for its formation but slows down the process of formation of information required for preparation, study and decision. The main result for the point of efficient internal control system view is an achievement of information transparency of major business centers.

For quality assessment of system functioning for a certain period of time it is required to carry out a

monitoring by economic agent. Therefore, it is advisable to allocate three components in the process of monitoring:

- Continuous monitoring
- Periodical monitoring
- Immediate monitoring (reports on identified disadvantages)

Offers for improvement of management processes are developed based on the results of analysis which finally is reflected in the package of internal standards. The main idea is that the monopolization of information must not be allowed by single subdivision or business center. Thus monitoring has to be conducted by several business centers from different positions.

That is why, one of the efficient offers of internal control is that organization requires determining the access of persons to information carriers. Tests which are conducted for confirmation of authenticity of financial statements should directly cover all activity areas of the organization rather than a single area.

Large organizations of corporate type having fairly stable organizational and financial structure with reserves of growth, established process for procurement and sales are desirable to move gradually to the new high-quality software technologies, including full-function, implemented on the basis of a single information space. This will allow to:

- Resolve the problems of capacity utilization and customers' orders inconsistency
- Increase the performance of employees' control activity
- Ensure the mode of organization management in the real time
- Ensure the efficient and coordinated interaction between departments avoiding duplication of information (Slabinskaya and Tkachenko, 2013)

Enhanced performance of economic agent internal control may be achieved by:

- Authentication and speed to obtain information on changes of internal and external environment conditions (reliable communication channels and information storages)
- Operational management and functioning of internal control that may be achieved through creating of special structural subdivision of control
- High level of professional training of employees, willingness to switch from one type of work to another
- Quick reorientation of control methods
- Ability to handle the resources (Anonymous, 2000)

Summary: Basic problem at the modern level of internal control development is to ensure the balance of all the elements of internal control so as to use the potential of economic agent most efficiently and improve its financial stability. Building of the efficient internal control implies determination of the most significant risks (that could lead to financial losses), development of control procedures and also creating a test system of control procedures efficiency.

CONCLUSION

These are the main directions of improvement of individual aspects of the internal control system. Their implementation should ensure the decrease of the possibility of abuse and economic agent property safekeeping as well as improvement, simplification and reduction of labor intensity of the control work which will enhance the efficiency of the internal control functioning. Improved efficiency of economic agent internal control may be achieved by:

- Authentication and speed to obtain information on changes of internal and external environment conditions (reliable communication channels and information storages)
- Operational management and functioning of internal control that may be achieved through creating of special structural subdivision of control
- High level of professional training of employees, willingness to switch from one type of work to another
- Quick reorientation of control methods.
- Ability to handle the resources

Practice shows that main mistakes which decrease the performance of control or nullify, it when creating the Internal Control Service are:

- Low culture of internal control
- Inadequate attitude to risk in the face of high financial results
- Disregard of the separation of powers principle
- Inadequate channels of data transmission
- Inactivity of management concerning the issues identified

Internal control does not deliver the expected results when management demonstrates their disparagement to control and does not take timely actions to correct identified faults. Common problems in the organization of internal control systems typical for Russian companies are:

- Absence of any form of control procedures in relation to any process
- Excessive Bureaucratization of control, concentration of internal control only on asset protection, privacy and preparation of management reports
- Lack of authorities for monitoring, conflict of interest in the system of control
- Lack of any kind of procedure in the business process being studied
- Using outdated or control procedures which are not concerted with other subdivisions
- Employee remuneration patterns too much focused on the short-term indicators
- Too negligible or on the contrary strict beyond measure penalties for violations and abuses

REFERENCES

- Anonymous, 2000. Internal Controls. Auditing Guideline: 2000. Dublin: ICAL.
- Chizhova, L.P., I.A. Slabinskaya and Iu.A. Tkachenko, 2014. Elements of Internal Control Model of Economic Agent. Basic and Applied Research of the Cooperative Sector of Economy, 6: 130-133.
- Slabinskaya, I.A. and Iu.A. Tkachenko, 2013. New Vision of Internal Control System Organization for Purposes of Company Management. Social and Humanitarian Knowledge, 8: 319-325.
- Slabinskaya, I.A., Iu.A. Tkachenko and L.P. Chizhova, 2014a. Technical Means of Internal Control in Retail Network. Basic and Applied Research of the Cooperative Sector of Economy, 1: 71-75.
- Slabinskaya, I.A., Iu.A. Tkachenko, O.B. Benderskaya and D.V. Slabinskiy, 2014b. Internal controls organization: a methodology approach. J.O. World App. Sci. 30, 10: 1205-1207.
- Tkachenko, Iu.A., 2007. Organization of Internal Control System as an Element of Company Management. Belgorod: BSTU Named after V.G. Shukhov.
- Tkachenko, Iu.A., 2014a. Directions of Internal Control Improvement of Industrial Enterprise. Newsletter of Belgorod State Technological University Named after V.G. Shukhov, 4: 112-115.
- Tkachenko, Iu.A., 2014b. Complex Control Systems in Trade. Belgorod Economic Newsletter, 3 (75): 163-168.
- Tkachenko, Iu.A. and I.A. Slabinskaya, 2014. Practice of Internal Control Organization of Industrial Enterprise. Newsletter of Belgorod State Technological University named after V.G. Shukhov, 6: 117-121.