

Disclosure of Information about Internal Control System in Corporate Reporting

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Abstract: The present study is devoted to one of the most urgent problems of accounting organization and preparation of accounts the issue of implementation of internal control in the companies. The purpose of the research is to determine the level of information disclosure about internal control system in the company's reporting. The research subject is industrial and economic activity of chosen companies. Public corporate reporting is the object. The researchers set out the following tasks in research process: to estimate the degree of study of the problem; to analyze public reporting including its structure, different report forms, the content of Explanatory Notes to the reporting and the working documents; to compare the reporting of various companies and to identify the degree of information disclosure. The methodology of the research suggests an analysis of existing studies in the field of internal control, visual analysis of internal documents of the companies and their reporting and comparative assessment of reports of some companies. The researchers study public accounts of the major companies, consider it from the view of completeness of disclosure of information about the internal control system, draw conclusions and give recommendations on improvement of control procedures. The researchers justify that the two concepts of internal control and internal audit are not the same. However, the management of some companies does not separate them. The researchers prove that internal auditing is only a part of the internal control system.

Key words: Internal control, risk management, internal audit, corporate reporting, working documents

INTRODUCTION

It is known that activity in the sphere of accounting, audit and taxation in the Russian Federation is strictly regulated. The government has developed various normative-legislative acts. The Federal law dated December 6, 2011 No. 402-fz "On Accounting" is effective in the sphere of accounting in the Russian Federation. One of the main requirements of the present law is that organizations must "organize and execute internal control of the committed business operation items, maintenance of accounting records and preparation of accounting (financial) statements". Thus, the object of internal control is not only maintenance of accounting records and preparation of statements based on its data but the very business operation items, i.e., any business operations, transactions, events which have or can have influence on financial state of economic entity, financial result of its activity and (or) cash flowss.

Since, there are still no separate methodic materials of the state researcherities which would regulate this process, the issue of formation of internal control system is often an element of the accounting policy of an

enterprise. As known, the basic moments of accounting policy must be disclosed in the accounting (financial) statements. Therefore, companies can disclose information about the current internal control system applied in the company in notes to their accounts (Sun, 2016).

We believe that activity of any company must be systematic and meet the requirements made by the government and by its owners and investors. As for implementation of internal control system into the process of company management, the management must firstly focus on the fact that this is a requirement of time, not requirement of law. If owners of the company and its investors are interested in a more detailed disclosure of information about functioning of internal control system, including internal control, the company management should comply with such needs of the consumers. Reality of economic development dictates its own terms which must be operatively considered by all the business entities in order to take effective measures. Operational efficiency of every company has its impact on the countrys well-being in general. Additional information about the company activity helps finding new investors

and potential buyers, thus, it makes the company's products more competitive. In the present terms, many major companies are interested in constant increase of quality level of produced goods, performed works and rendered services (Kaspina and Plotnikova, 2014). This is aimed at increase of their competitiveness and increase of demand for own products, works and services. Herewith when developing the business strategy, the company management associates the line of increase of quality and reliability level of goods, works and services with the other important strategic blocks (Needles *et al.*, 2010). They include:

- Effective operating of the system of management over assets of own company
- Improvement of internal control system

MATERIALS AND METHODS

Since, improvement of internal control system in a company is tightly connected with increase of efficiency and rationality of its functioning, we suppose that it needs to be considered in interrelation with other elements of business management which is depicted in Fig. 1. The internal control system provides performing of control functions in two lines: in part of all the committed business operation items and accounting (financial) statements in general. Internal control provides higher results rating of the company activity and authenticity, completeness and timeliness of preparation of the company's accounts. Thus, internal control entities must perform specific procedures and actions in order to business operation. Such mistakes can be connected with

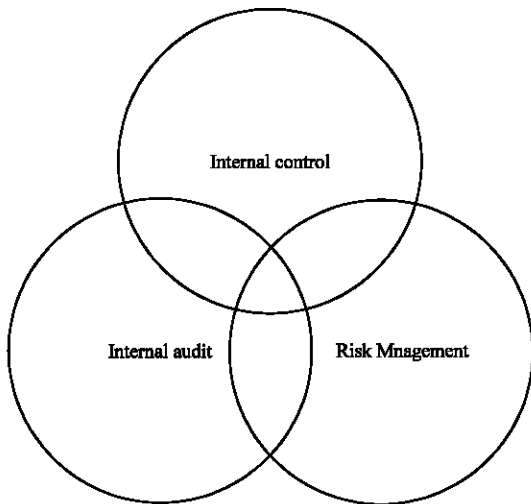


Fig. 1: Interrelation of functions of company activity management

violation of law requirements in any sphere, illegal actions of the company employees, violation of conditions of the company's internal documents and other types of violations. Timely detection of any deviations and violations at the moment of performing a business operation increases reliability of accounting information and so the most accurate financial statements can be formed. Besides current and regular control of business, operation items and accounting records help decreasing and even avoiding all existing risks. So, in our opinion, internal control is a necessary system in the company for its risk management potential.

In order to minimize risks, companies must adjust a system of their management. Risks of the company are dependent on both external and internal factors and with needed information the company will be able to manage and reduce them. Risks have negative impact on the results of financial and economic activity of the company, for example, materials losses (Bagley *et al.*, 2016). Risk management excludes reasons of failure to achieve the objectives of the company and forms protective barriers and prevents abuses.

In turn, it is necessary to maintain internal audit in the company for evaluation of reliability of internal control system. It means that this is the next stage of the internal control system which is targeted at expression of objective and independent opinion on efficiency of performed control procedures and rationality of risk management. In our opinion, one shouldn't equate the two notions "internal control" and "internal audit". There is one very important difference. Control is performed directly at the moment of planning and documentary execution of any business operation or in the process of preparation of accounting (financial) statements. As for audit, it provides supervision of already committed business operation item and is aimed at inspection of its compliance with the norms of legislation or internal requirements of the company. Thus, internal control has three main stages preliminary, current and consequent stages. At the preliminary stage, control environment must function in the company in business lines and specific areas of accounts which should be formalized in the form of working documentation. As we suppose, at this very stage functions of risk management are performed, identified and evaluated.

The current control provides direct performance of all control procedures and actions on every business line (business-processes) and every section of accounting work. And finally, the next stage of internal control is implemented in supervisory procedures of audit and tracking of implementation of recommendations on further improvement of internal control system. Considering

Table 1: Disclosure of information in annual accounts of the companies for the year of 2014

Companies and elements of their annual report for 2014	1 (PJSC "Lukoil" ¹)	2 (PJSC "TVEL" ²)	3 (PJSC "Kubanenergo" ³)	4 (PJSC "NKNH" ⁴)	5 (PJSC "Vimpel-Kommunikacia" ⁵)	6 (PJSC "FSK EES" ⁶)
Types of activity	Extraction and processing of oil and gas	Development, production and sale of nuclear fuel	Transmission and distribution of electricity	Production of synthetic rubber, plastics, monomers and other products	Telephony services, data transmission, Internet access	Electric power transmission
Disclosure of information about internal control system in following elements of annual report						
Development strategy of the company	-	+	+	-	-	-
Corporate management report	+	-	-	-	-	-
Disclosure of information about following local documents in part of internal control system in annual report						
Documents of audit Committee activity	+	+	+	+	-	+
Documents of internal control	-	+	+	-	-	+
Documents of risk management	-	+	+	-	+	+
Documents of internal audit	-	+	+	-	-	-

¹Official website of company, 1: <http://www.lukoil.ru/>; ²Official website of company, 2: http://www.tvel2014.ru/ru/section_0/; ³Official website of company, 3: <http://kubanenergo.ru/>; ⁴Official website of company, 4: <https://www.nknh.ru/>; ⁵Official website of company, 5: <http://moskva.beeline.ru/about/about-beeline/>; ⁶Official website of company, 6: <http://www.fsk-ees.ru/>

these three management functions in the company in tight correlation (Fig. 1) we believe that they must be performed by different employees of the company (who are conditionally independent from each another). For example, if an ordinary accountant or a deputy chief accountant performs internal control of business operation items of a specific accounting area at the stage of documentary execution, then internal audit (inspection) of this business operation item must be performed by an independent expert after its performance and execution in the accounting system. For instance, employees of internal control department can act as such experts. In our opinion, in order to achieve objectivity of inspection results, it cannot be allowed that further inspection is performed by the accounting service employee.

We think that in order to achieve high systematicity of employee's work in any company it is necessary to have a more qualitative approach to the process of developing internal working documents of the company which regulate its activity. Composition and contents of the working documents must be urgent and meet up-to-date requirements of legislation and consumers of the accounts. They must comprise the whole system of management existing in the company (Greco *et al.*, 2015). In our opinion, the company must develop working documents in part of functioning of internal control system and internal audit. These documents can be represented by the Code, Policy, Provisions, Regulations, Instructions, Decrees and others. The following moments must be specified:

- Objective, tasks and principles of internal control organization
- Aspects of internal control
- Stages, types and levels of internal control implementation
- Procedure of internal control implementation

- Role of participants, their correlation, responsibility
- Further control of procedures execution

We held express analysis of the annual accounts of several public companies which are engaged in types of activity varying from each other. We had a task to define the degree of completeness of the companies' disclosure of information about the corporate management system functioning in part of three lines: internal control, risk management and internal audit. Results of the analysis are represented in Table 1.

RESULTS AND DISCUSSION

It can be concluded that most of the companies are interested in detailed disclosure of information about management system. It should be noted that annual accounts of some companies look quite informative and are represented in the form of interactive Web-page. However, there are some data hidden from external users. So for example, all the analyzed objects have development strategy (Mission) of the company. But not all events on further business development which are specified in the development strategy provide improvement of the internal control system. Exceptions are companies number 2 and 3. They planned implementation of some events on improvement of its operation. The company number 1 provided detailed disclosure of Corporate management report which includes information about the results of audit of internal control system which was held in 2014. This has specific interest to us. However, the company presents brief information about own working documents of internal control. It seemed to us that the most complete and detailed annual account was provided by the Public Joint Stock Company of Power Supply and Electrification

of Kuban (PJSC “Kubanenergo”) which is engaged in delivery and distribution of electric power in the territory of Krasnodar Krai and the Republic of Adygea. We investigated the structure and composition of the annual accounts of the company about availability of information on the internal control system functioning in the company. We consider that every year PJSC “Kubanenergo” in its annual accounts presents all information about its activity which is necessary for external users. Particularly annual accounts of the studied company include the following sections:

- Key indicators of activity
- Address of the chair of the board of directors and the director general of the company
- Information about the company
 - Position at the market
 - Consumers of services
 - Business scheme
 - Regulation of activity
 - Organizational structure
 - History of formation and development
 - Key events of the company during a year
- Development strategy
- Results of operational activity
- Investment activity
- Financial results
 - Accounting (financial) statements of the company
 - Results of financial and economic activity
- Corporate management
- Internal control and risk management
- Shares and dividends
- Steady growth
- Appendix
 - Annual accounting records of the company and auditor’s report
 - Characteristics of property complex of the company
 - Review of major transactions and transactions with interest
 - Report on compliance with the corporate management code
 - Review of internal documents of the company
 - Participation of the company in other organizations

Some conclusions were made on the basis of the internal documents of PJSC “Kubanenergo” which we have previously reviewed. Development strategy of the studied company is rated until 2030 and includes target marks, development perspectives and priority business lines. Priority business lines of the company include

improvement of internal control system, risk management and internal audit. In our opinion the positive moments of the presented document is that the company associates all the aforementioned main elements of management system with each other (Fig. 1). The company formed audit committee which is researcherized along everything else to supervise the systems of risk management, internal control and corporate management. There are such regulating documents as “Provision on Audit Committee” and “Policy of Internal Audit”. It is pleasant to understand that the Audit Committee is not charged to perform the role of guarantor of authenticity of accounts, efficiency of risk management systems, internal control, corporate management, compliance with legislation but to control implementation of own obligations on provision of authenticity of accounts, formation of reliable and efficient systems of risk management, internal control, corporate management, compliance with legislation and internal documents of the company.

It should be noted that risk management in the company has a regular nature which is clear from the accounts of this company for the previous periods. Herewith the following risk groups are distinguished and controlled key operational risks, operational risks of the main business processes and operational risks of other business processes. This issue is regulated in the studied company by the internal document policy of risk management.

According to this policy risks are analyzed as per two parameters-probability of their occurrence and degree of potential damage for the company (degree of the event’s impact of the business indicators). In our opinion, this document needs to be improved in part of determination and more detailed specification of people who can act as risk “owners” and executors of control procedures. Internal documents of PJSC “Kubanenergo” do not include methodic materials for executors of control functions. We hope that these normative documents are available in this company. We consider that methodic instructions for the process of risk management must be developed as an element of working documentation and they must include the following moments:

- Periodicity of monitoring, detection and evaluation of risks
- method of implementation of control procedures in the course of risk management
- procedure of development of risk management events and control over their implementation
- means of processing of information about risks and its further disclosure in the accounts
- scheme of coordination of actions of all participants of risk management system

In part of internal control activity of the studied company is also regulated by the working document "Policy of Internal Control". This document is based on experience of the leading world and Russian companies and is developed for implementation of provisions of the Strategy of development of electric network complex of the Russian Federation approved by the Decree of the Government of the Russian Federation dated April 3, 2013 No. 511-p. The policy defines objectives, principles of functioning and elements of the internal control system of the company, the main functions and responsibility of participants of the internal control system, procedure of evaluation of efficiency of the internal control system.

We believe that for implementation of all requirements contained in the present document it is necessary to form additional, more detailed, methodic instructions for coordination of actions of all structural divisions of the company. They will allow the executors (subjects of internal control) to perform more coordinated actions in this part and to exclude possible duplication of held control procedures or business operation item or element of accounting records. At the same time, it is important to make sure that the executor of the accounting operation could not control the same process. We consider that the company already has such methodic materials but they are not disclosed in the accounts for a wide range of users. In our opinion, it is indeed unnecessary; it is quite enough for the internal users and executors of control procedures to be aware of the method of control functions implementation.

CONCLUSION

So, it should be noted that the annual accounts of the major companies as in the case of the studied annual accounts of PJSC "Kubanenergo", information about the internal control system, risk management and internal audit system is disclosed for external interested users. However, level of disclosure is quite low and it is just that internal regulating documents in part of management in general are only mentioned to be available. In our opinion, internal and external users would like to know about problem areas and results of monitoring of internal control system, about level of evaluation of existing risks and other aspects of corporate management system. The following events can be recommended for further improvement and implementation in the internal control system in the major companies:

- Differentiation of control procedures on every business process with regard to the type of the company's activity (Karande and Kalbande, 2015)

- Distribution of duties between executors of control functions on separate areas of accounting records and fiscal accounts and in the course of execution of accounting (financial) statements
- Holding of control procedures in constant correlation and direct dependence on the detected risks
- Implementation of internal audit system and regular supervision of efficiency of use of means of internal control of business operation items
- Use of the unified automated management system, including risk management, holding of internal control and audit
- Formation of qualitative working documents of the company in part of development of internal standards of practical use in the course of implementation of control procedures
- Increase of quality level of professional judgment of specialists on the preliminary stage of organization of internal control system and in the process of implementation of control functions

We believe that the aforesaid events will provide the company with a steadier financial position at the market, increase its confidence in authenticity of own accounting (financial) statements and thus will increase the level of disclosure of results of audit of the internal control system and events on its improvement to the interested parties. Of course, the process of organization of internal control system mainly requires a high level of professional judgment of the specialist in the sphere of accounting and audit. Reality of the modern practice determines the list of cultural and professional competences which a graduate of accounting faculty must have. We consider that the competence approach in training of graduates which is now recognized in the educational activity, will meet the need for the real professionals.

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