

ORGANIZATION AND FUNCTIONING OF THE INTERNAL CONTROL SERVICE IN AN OUTSOURCING ORGANIZATION

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Abstract: *Any business entity, regardless of the form of ownership and type of activity, faces risks caused by constant changes in the environment in which it exists. The internal control should provide management with information that allows more efficient use of available resources, prevent fraud and misrepresentation of reporting, correct business processes in time and, ultimately, increase the value of the company. The most important task of any business entity in this case is not the formal allocation of the subjects of control – internal controller or control service, but its organization in accordance with modern requirements, in the center of which is a risk-oriented approach. That is why the study of methods and ways of organization of internal control service is relevant for any business entities. One of the most important directions of the internal control service is risk assessment and management decision-making system, evaluation of the effectiveness of the chosen strategy of the company, as well as the implementation of management orders by employees. Thus, nowadays, for successful business and effective management of the enterprise, managers and owners of enterprises need to form an internal audit service, which will identify not only existing shortcomings, but also to prevent serious violations. The article offers methodological recommendations on the organization of internal control service in economic entities.*

Keywords: audit, internal audit system, control procedures, internal control system.

The definition given in International Audit Standard 315¹ states that “The internal control system is a process developed, implemented and

¹ International Standard on Auditing (entered into force on the territory of the Russian Federation by the Order of the Ministry of Finance of Russia dated 10.24.2016 No. 192n), 2016. Available at: <http://legalacts.ru/doc/prikaz-minfina-rossii-ot-24102016-n-192n-ovvedeni/>; International Standard on Auditing 315 (revised) “Identification and assessment of risks of material misstatement by studying the organization and its environment” (entered into force in the territory of the Russian Federation by the Order of the Ministry of Finance of Russia dated 10.24.2016 N 192n), 2016. Available at:

supported by those responsible for corporate governance, management and other employees of the organization to ensure reasonable confidence in achieving the organization's objectives in the preparation of reliable financial statements, effectiveness and efficiency, as well as compliance with applicable laws and regulations".

The presence of a financial controller, however, does not mean that it accumulates all the functions of the internal control service within its job responsibilities. In most cases, the functions of the internal control service are divided between several control subjects²:

- accounting company (thus, not only accounting and reporting but also part of the functionality of the internal control service is outsourced);
- financial controller;
- other employees of the organization;
- parent company.

Given the above, we consider the organization and functioning of each of the four components in this article.

Internal control organization

Various internal regulatory procedures, the implementation of which allows to improve the quality of services and reduce the risk of errors in accounting, are implemented in the internal control department of the outsourcing organization³. The internal control department of an outsourcing organization⁴:

- establishes and monitors the implementation of regulatory procedures;
- develops accounting and tax accounting standards, accounting policy templates, etc.;

<http://www.consultant.ru/cons/cgi/online.cgi?req=doc&base=LAW&n=207071&fld=134&dst=1000000001,0&rnd=0.6701789343970102#05094872846698926>

² E.I. Efremova, "Organization fraud – methods of struggle", in *Leasing*, 2014, no. 9, p. 60-66; A.E. Shevelev, E.V. Sheveleva, *Risks in accounting*, KNORUS, Moscow, 2015; I.T. Abdugarimov, L.G. Abdugarimova, V.V. Smagina, *Analysis of financial and economic activity of the enterprise*, TSU them. G.R. Derzhavina, Tambov, 2015.

³ E.M. Akhmetshin, V.L. Vasilev, D.S. Mironov, E.I. Zatsarinnaya, M.V. Romanova, A.V. Yumashev, "Internal control system in enterprise management: Analysis and interaction matrices", in *European Research Studies Journal*, 2018, vol. 21, no. 2, p. 728-740.

⁴ V.Ya. Vilisov, I.E. Sukov, *Internal controls*. Infra-M, RIOR, Moscow, 2015; D.I. Zaripova, "The method of implementing an effective system of internal control in the enterprise", in *Young Scientist*, 2015, no. 3, p. 421-424; N.A. Kazakova, *The concept of internal control of the effectiveness of the organization*, Infra-M, Moscow, 2015.

- participates in the preparation and conduct of professional training for company employees;
- provides methodological support to accountants;
- conducts regular quality checks of the accounting ("spot checks").

This subject of control is responsible for the accuracy, completeness and timeliness of financial statements from the selected tasks of internal control⁵.

However, the functions of the internal control department are not limited to the implementation of control in the narrow sense (i.e., financial control, control over the correct recording of business transactions in the account and their documentation) and the audit function.

The traditional approach to organizing the internal control service is not enough: a modern understanding of the internal control system requires a risk-based approach that is not focused on the regulation and audit of accounting records⁶.

Therefore, current trends and elements of a risk-based approach should be taken into account when forming the organization's internal control service. In particular, the development of a requirement to provide clients with information on legal, financial and tax risks when performing non-standard operations both in the course of current activities and necessarily on a quarterly basis in the following format:

- description of the existing risk;
- assessment of the possible consequences of the risk (including, in monetary terms, if possible);
- proposed measures to eliminate/reduce the risk to an acceptable level. Example of providing risk information – Table 1.

Table 1: Sample risk information provided by the organization

Risk Area	Risk Description	Risk Assessment	Recommended Actions
Profit Tax / VAT / PIT	During 2017 there were many cases of late submission of documents, both from suppliers and employees.	We would like to emphasize that this fact distorts the taxable base for the purposes of calculating VAT and	Improve communication with suppliers and motivate employees to

⁵ E.M. Akhmetshin, "The system of internal control as a factor in the integration of the strategic and innovation dimensions of a company's development", in *Journal of Advanced Research in Law and Economics*, 2017, vol. 8, no. 6, p. 1684-1692.

⁶ E.M. Akhmetshin, V.L. Vasilev, S.I. Bakhvalov, A.N. Prikhod'ko, A.V. Kazakov, "Internal control in the system of innovation management in the modern business environment", in *International Journal of Economic Research*, 2017, vol. 14, no. 15, p. 409-416.

	<p>As a result, expenses are recognized in the subsequent period, and not in the one in which they occurred. Thus, the organization did not take into account the input VAT, which could be deductible. Profit tax was also accumulating for several months.</p>	<p>profit tax. Auditors and tax authorities pay particular attention to the period of recording of expenditure. As long as the organization makes a profit, the risks are minimal. But in case of losses, the company will be obliged to adjust the income tax return for the previous period (s).</p>	<p>provide documents on time.</p>
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Responsible for internal control

The above information is provided by accountants directly involved in the project. Therefore, two groups responsible for the implementation of internal control can be identified within the subject of internal control (outsourcing organization): the department of internal control of an organization that develops accounting and reporting standards, as well as checking their compliance, as well as directly responsible accountants providing information on specific risks, which include the falsification of accounting (financial) statements. “Reporting falsification can occur when information is intentionally omitted or distorted when preparing reports of an organization. This can occur when concealing unauthorized income or expenses, committing financial fraud or other violations in disclosing information”⁷.

In addition, some aspects of internal policy and the provisions of the organization should be developed by the organization’s specialists:

- accounting policy (business and tax accounting);
- wage and bonus regulations;
- travel regulations;
- timetables.

The second subject of internal control in an organization is a financial controller – an official who reports directly to the Director General.

His responsibilities and activities should be more consistent with the objectives of the internal control service, as a unit responsible for the internal control of the organization, and the internal controller’s

⁷ E.I. Bakhtigovina, N.D. Ustinova, G.A. Stulov, “Fraud risk assessment in accounting financial statements”, in *Economy and Entrepreneurship*, 2017, vol. 5-2, no. 82-2, p. 595-598.

responsibility is to “report any grounds for believing that the deals or financial transactions of the entity being audited could or can be implemented in order to legalize (launder) proceeds from crime, or to finance terrorism, the federal executive body responsible for the development of state policy and legal regulation in the sphere of countering the legalization (laundering) of proceeds from crime, and the financing of terrorism in accordance with the procedure prescribed by law” Federal Act of 31 December 2008 No. 307-F3 “On Auditing” (Article 13, paragraph 3.2, 2008)⁸; “Notice of facts of appeal with a view to incitement to commit corruption offenses” Federal Act No. 273-F3 of 25 December 2008 “On Combating Corruption” (Article 9, paragraph 2, 2008)⁹.

Responsibilities and powers of the financial controller cover the following areas¹⁰:

1. Development of internal regulations, provisions and policies of the organization, including:

- sales regulations, which determine the procedure for coordinating the deal at all stages: from initiation to closing;
- discount provisions and payment terms governing the procedure for granting deferred payments to customers;
- corporate car policy;
- procurement policy;
- algorithm for hiring and firing employees, and others.

2. Approval of transactions for the sale of goods and services, including:

- verification of the reliability of counterparties and the assessment of possible risks during interaction with them;

⁸ Federal Act of 31 December 2008 No. 307-F3 “On Auditing” (as amended on 01.12.2014), 2014. Available at: <http://www.consultant.ru/popular/auditor/>.

⁹ Federal Act No. 273-F3 of 25 December 2008 “On Combating Corruption” (with amendments and additions), Guidelines for the development and adoption by organizations of measures to prevent and counter corruption (approved by the Ministry of Labor and Social Protection of the Russian Federation on November 8, 2013), 2013. Available at:

<http://www.consultant.ru/cons/cgi/online.cgi?req=doc&base=LAW&n=310135&fld=134&dst=1000000001,0&rnd=0.173564367368354#06264255450812721>.

¹⁰ O.V. Kryshkin, *Handbook of internal audit. Risks and business processes*, Alpina Publisher, Moscow, 2015; R.V. Makeev, *Establishing internal control systems: from reporting audits to business performance*, Vershina, Moscow, 2015; S.M. Reznichenko, *Modern internal control systems*, Feniks, Moscow, 2015.

- taking measures to reduce the company's risks when dealing with unreliable clients (letters of guarantee, bank guarantees, the inclusion of conditions in the contract, increasing responsibility for non-performance of obligations, etc.);

- coordination of special conditions for the supply of equipment or payments (which are in conflict with the existing policy of payment terms and discounts, for example, 100% postpay for customers);

3. Approval of transactions for the procurement of goods and services, based on their expediency and profitability;

4. Control over current operations, including:

- payment authorization;

- control over the provision of all necessary documentation by employees (on sales, acquisitions, travel and other expenses) – this function is implemented together with the accountants of the organization;

- control of receivables.

5. Formation of plans and budgets for the upcoming periods and control over their implementation;

6. Formation of internal reporting according to the standards of a group of companies and providing it to organization controllers.

The scope and responsibility of the financial controller are somewhat broader than that of an outsourcing organization; however, it is also more concentrated in the field of finance.

Functions of the internal control service

The functions of the internal control service, as emphasized above, can also be performed by other employees of the company in addition to the financial controller – these are Director General, Branch Manager, Sales Director. It should be noted that the transfer of responsibilities for the implementation of internal control to top management is a common practice among small enterprises.

Employees of the organization can perform the following control functions.

1. Sales Director:

- approval of transactions in terms of delivery terms and settlements, including discounts;

- control of receivables against sales customers;

- control over current operations related to the sales department (economic and travel expenses).

2. The control functions of the Branch Manager largely coincide with the functions of the Sales Director, adjusted for another division:

- approval of transactions in terms of delivery terms and settlements, including discounts;
- control of receivables against customers of the department;
- control over current operations related to the department (economic and travel expenses).

The control functions of the Director-General largely overlap and even duplicate those of the Sales Director. In addition to top management, control in the organization is carried out by some other employees as part of their job duties: for example, the Sales Manager for spare parts must control their movement, the Logistics Specialist controls the movement of equipment, etc.¹¹

“The fundamental function of the modern system of internal control of financial results is its presence at all stages of the organization’s management”¹².

Thus, the control functions of the company as a whole should be concentrated on the compliance of indicators in terms of sales, the degree of compliance with the budget and other financial plans. Also, the company should control major transactions or non-standard conditions of supply and settlement, which are beyond the powers of the financial controller in terms of value.

When summarizing the results, it is important to emphasize once again that in the absence of a separate internal control unit in an organization, the control functions at the level of the organization as a whole are distributed among several subjects indicated in the article.

It is assumed that the application of this type of guidance in the educational process leads to a reduction in the time for learning the basics of computer programs and the optimal logical direction of thinking activity. Consequently, it significantly helps to perform more serious tasks, which form the corresponding engineering thinking. The presented fundamental principles, recommendations, conclusions on the creation of a methodical guideline can be used both in computer and other disciplines in any educational area.

¹¹ D.A. Kaldiyarov, A.M. Baltabayeva, A.E. Bedelbayeva, “Competent role of anti-crisis management in the development of economy in the Republic of Kazakhstan”, in *Espacios*, 2017, vol. 38, no. 48, p. 20.

¹² N.A. Kazakova, E.I. Efremova, *The concept of internal control effectiveness of the organization*, Infra-M, Moscow, 2015.