

## THEORETICAL AND PRACTICAL ASPECTS OF RISK ASSESSMENT IN INTERNAL FINANCIAL CONTROL SYSTEM



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**Abstract.** The article studies the essence of internal financial control as an important component of the enterprise management system, which ensures timely identification of risks and adequate response to them in order to minimise negative consequences or avoid them. The main elements of the internal financial control system are summarised and the need to assess the risks that affect the effectiveness of this system is substantiated. The principles and requirements for risk assessment are presented, qualitative and quantitative methods of their analysis are described, which should be based on a systematic approach, characterised by adaptability, regularity and integration with the enterprise management system, which will help to improve the quality of internal financial control and optimise management processes.

**Keywords:** *management, system approach, internal financial control, risks, assessment, methods, monitoring, adaptability*

### Introduction

In today's challenging conditions of the national economy, new approaches should be applied in the enterprise management system, with special attention being paid to the functioning of internal financial control, which involves monitoring, verification and evaluation of the achievement of certain goals aimed at improving the efficiency of the financial and economic activities of the enterprise and its development, ensuring the reliability of accounting and reporting data in accordance with the applicable law. An important criterion for the effectiveness of the internal financial control system is its ability to detect the negative impact of both internal and external environment factors. This is possible, in particular, due to the qualitative assessment of risks in the company's financial control system, which contributes to the timely identification of weaknesses in the financial resources management system, prompt implementation of a set of measures to respond quickly to identified problems in the company's activities, and improvement of the internal financial control system itself.

**Literature review.** The study of certain theoretical and practical aspects of the formation of the internal financial control system and risk assessment as an important element of this system is devoted to the works of domestic and foreign scholars, in particular: Dayal Raghubir, Zachariah Peter and Rajpal Kireet (1996); Maksimova V. (2005); Butynets T. (2008); David L. Olson and Desheng Dash Wu (2008); Donald R. Van Deventer, Kenji Imai and Mark Mesler (2013); Vaclovas Lakis and Lukas Giriūnas (2013); Kamenska T. and Redko O. (2015); Hulay I. (2016); Tanasieva M., Zamula I. and Nykyforak I. (2021); Kavchenko M., Boyarinova K. And Kopishinska K. (2021), et.al.

**Research methodology.** The theoretical and methodological basis of the study is based on the provisions of economic theory, as well as theories of internal control, risk management, finance, accounting, corporate governance, and others. The study used the following scientific methods: analysis (in the study of the essence of internal financial control of the enterprise); systematic approach (in which internal financial control is considered from the point of view of an element of the enterprise management system and includes various interrelated components that interact with each other); pragmatism (in determining the criteria for the effectiveness of the internal financial

control system with a focus on the economic benefits received by the enterprise); dialectical method (in studying the contradictions that may arise between opportunities and threats in the internal financial control system); comparison and structural-logical analysis (in studying existing methodological approaches to risk assessment in the internal financial control system); generalisation (to determine the types of risks in the internal financial control system).

**Research results.** In 1949, The AICPA Committee on Auditing Procedures in its report first interpreted the concept of 'internal control' as '[t]he plan of organisation and all of the coordinated methods and measures adopted within a business to safeguard its assets, verify the accuracy and reliability of its accounting data, promote operational efficiency, and encourage adherence to prescribed management policies' (Tippos). Today, the American Institute of CPAs website provides the following interpretation of internal control: 'Internal control is the process of assuring the achievement of your objectives in operational efficiency and effectiveness, reliable financial reporting, and compliance with laws, regulations, and policies' (AICPA&Cima).

These definitions focus on the tasks of internal control, the key of which is to ensure: efficient use of the company's resources and business processes in general; accuracy and reliability of accounting and financial reporting data; compliance of business operations with the applicable laws and internal policies of the company. This approach to understanding the concept of internal control is more consistent with its financial component, so we will consider it from the point of view of internal financial control.

As an economic category, financial control of an enterprise has a set of characteristic features. We agree that financial control should have such properties as: efficiency, purposefulness, immediacy, validity, and effectiveness (Honcharuk, Dolbneva, Pryimak, Romaniv 2017, p. 10). At the same time, we believe that such features as systematicity are equally important, since internal financial control is one of the elements of the management system, and its functioning should contribute to the achievement of the strategic goals of enterprise management, in particular, ensuring the efficiency and stability of its activities, optimisation of financial

resources, etc; integration based on the interconnection with the management accounting system, which allows to promptly detect deviations in financial indicators and timely respond to these changes; regularity, which consists in constant monitoring of internal processes and environmental factors in order to identify threats and timely respond to them; *adaptability*, which implies the ability of the internal financial control system to be flexible to changes, which is important in the context of uncertainty of the enterprise's operation.

In order to promote the efficiency and reliability of control procedures and the objectivity of their results, it is necessary to create conditions to ensure the independence of financial control, and it is important to prevent conflicts of interest.

In general, internal financial control should be considered as a set of organizational structures, methods and procedures that are performed by the relevant entities of the enterprise, which are endowed with control functions, the purpose of which is to form high-quality and timely information on financial and economic activities, necessary for the preparation, justification and adoption of optimal management decisions. Internal financial control also involves checking compliance with the requirements of current legislation on conducting business activities, the reliability of the reflection of data on assets, capital, liabilities and business transactions in the accounting and reporting system, prevents violations and errors in the accounting process and when making management decisions, etc. (Yurchenko, Klymenko 2021, pp. 405-406).

The main elements of the internal financial control system include:

- internal environment (organizational, material, personnel and information and documentary subsystems, which are interconnected taking into account processes, regulations, structure, distribution of powers, rules and principles of management, etc.);
- subjects of the internal financial control system (management of the enterprise and its structural units, economic units (accounting, financial, planning departments), or a separate internal control (audit) department);

- objects of the internal financial control system (financial and economic activities of the enterprise and its reporting);
- means of internal financial control (a set of methods of universal (documentary and actual) and specific control, the implementation of which takes place at all levels and is aimed at risk management in order to achieve a strategic goal);
- internal financial control functions (determined by the management or owner of the enterprise, taking into account the content and specific features and indicators of its activities, management system and other criteria) (Izhboldina 2023, pp. 97-98).

The internal environment also needs to take into account the values and elements of the corporate culture of the enterprise, which significantly affects the effectiveness of internal control. In order to build trust between the management and personnel of the enterprise, it is important to establish communication openness and transparency. An increase in the level of responsibility is achieved on the basis of the active involvement of enterprise employees in control procedures. By clearly dividing responsibilities and fixing them in internal regulatory documents, it is possible to avoid duplication of functions, ambiguity in job responsibilities, and abuse.

The effectiveness of control procedures is also achieved by improving the qualifications of employees involved in the internal financial control system. Constant changes in current legislation and the business environment, which create new requirements for accounting and financial reporting, and the implementation of economic activities, require a quick response and adaptation to these changes in order to prevent errors in professional activities and ensure high-quality control.

An established risk identification system allows for more thorough decision-making regarding the management of the company's finances, planning activities taking into account possible crisis events that may arise under the influence of internal and/or external environmental factors, and understanding which tools will be used to protect financial resources and the financial security of the company as a whole.

Among the main risks of the internal financial control system, the following can be distinguished: the risk of unreliability of

accounting data and financial reporting (due to incorrect implementation of accounting procedures, failure of the accounting process software); the risk of inconsistency in the level of professional skills of employees, lack of the necessary level of knowledge or experience in performing their duties; the risk of absence or inaccuracies of formalized rules and standards for organizing and conducting financial control at the enterprise; the risk of choosing tools and timing of control procedures; the risk of failure to detect violations of the object being inspected (the risk of dishonesty, negligence of the controller, the risk of making incorrect tactical decisions by the management of the service).

The disadvantages of forming an effective system of internal financial control, which limits the ability to qualitatively perform control functions for identifying risks at enterprises, are:

- internal financial control is usually focused on checking individual areas of the enterprise's activity, such as compliance with cash discipline, correctness of tax payments, reliability of data on inventory movements, formation of product cost, etc., as a result of which the control is devoid of a comprehensive nature;
- the enterprise's software and information and communication technologies are not fully used, which complicates the process of risk control and monitoring;
- the lack of a single standard for training specialists in the field of internal financial control in terms of forming general and professional competencies that allow them to qualitatively perform professional duties, work effectively in a team when implementing financial control, etc.

In the internal financial control system, in addition to identifying risks, their assessment plays an important role. Based on systematic risk assessment, it is possible to predict potential threats to the economic development of an enterprise, which allows avoiding or minimizing financial losses and ensuring safe and stable functioning in conditions of uncertainty.

In 2013, the COSO Concept was developed, which formalized the principles of internal control within its five main components: control environment, risk assessment, control activities, information and communication, and monitoring. The implementation of this Concept allows

enterprise management to qualitatively diagnose problems and assess the effectiveness of internal control tools, as well as avoid significant shortcomings or problems in financial reporting. According to the COSO Concept, the main principles of risk assessment should be:

- specifies suitable objectives;
- identifies and analyzes risk;
- assesses fraud risk;
- identifies and analyzes significant change (McNally 2013).

In accordance with these principles and the interpretation of the concept of "internal control", we can note that risk assessment: should take place in the context of achieving the strategic goals of the enterprise; involves identifying risks that negatively affect the effectiveness of its activities, the reliability of financial reporting, violations of applicable legislation and internal rules; should be based on the use of scientifically sound qualitative and quantitative methods of risk assessment and analysis; provides for the development of specific measures, based on the results of control actions, to reduce financial losses or eliminate risks and further monitoring of changes.

In the process of identifying risks and developing measures to manage them, it is important to take into account the specifics of the enterprise's activities and the relationships that arise between various risks, and their impact on the efficiency and financial stability of the enterprise, which is implemented on the basis of a systemic approach.

Therefore, risk assessment methods in the internal financial control system include a set of approaches and tools that allow identifying these risks, analyzing and assessing their impact on the efficiency of the enterprise's activities and its sustainable development, which is the economic basis for implementing measures to manage them, in particular, aimed at minimizing possible losses or avoiding them.

Risk assessment methods can be divided into two groups:

- methods of qualitative (logical) risk analysis – based on the use of subjective assessments to determine correlations and order indicators; involves identifying risks, identifying sources and causes of their occurrence, establishing potential risk zones, identifying possible benefits and negative consequences of implementing

solutions (Kravchenko, Boyarinova, Kopishinska 2021, p. 126). Examples of qualitative risk analysis methods are methods of expert assessments involving specialists in this field who will study risks, taking into account their professional experience, or SWOT analysis, which allows assessing strengths and weaknesses, opportunities and threats, i.e. a systematic approach to identifying risks;

- methods of quantitative risk analysis – based on the use of numerical assessments and indicators on which basic mathematical operations can be performed (Kravchenko, Boyarinova, Kopishinska 2021, p. 133). In particular, such methods involve conducting statistical analysis with the prediction of possible risks or their modeling based on econometric models.

When assessing risks, it is important to examine such indicators as the probability of risk occurrence and the magnitude of possible losses. The first indicator is calculated based on the ratio of the number of adverse factors to the economic activity of the enterprise that affect its economic efficiency to the total number of cases in the statistical sample. When determining the magnitude of possible losses, the probability of economic losses and the cost estimate of these possible losses for the enterprise should be taken into account (Tanasiieva, Nykyforak 2021, p. 31).

A modern tool for identifying and assessing risks in the internal financial control system is a process method, which is based on a systematic study of business processes and identification of possible threats at each stage. The key task is also to introduce a set of tools and procedures for their implementation at the enterprise, which will allow to promptly reduce or eliminate the identified risk. A high-quality system for monitoring the implementation of control measures and assessing their effectiveness will allow to adapt in a timely manner to changes in the internal and external environment and prevent the emergence and negative impact of new threats. It is also worth paying tribute to the scenario analysis method when assessing risks in the internal financial control system, which involves the development of alternative scenarios for the possible development of events related to the activities of the enterprise, which will affect the financial condition and results of its activities. The possible consequences of the impact of risks

under each of these scenarios should be assessed and recommendations should be developed on the most effective measures and

methods of managing these risks, which will allow to quickly respond to their emergence and negative impact.

### Conclusions

Effective risk management is an important component of the internal financial control system, which is based on the use of a set of methods for identifying and assessing such risks to ensure financial stability, sustainable economic development and efficiency of the enterprise. Qualitative risk assessment will provide the management system with reliable information for making informed management decisions, will contribute to the improvement of business processes and the ability to respond in a timely manner to changes in the internal and external environment in order to minimize financial losses or avoid them. The risk assessment subsystem in the internal financial control system should be based on a systematic approach, occur on a regular basis, be flexible due to the ability to adapt to changes, be integrated into the enterprise management system, which in turn will contribute to the effectiveness of assessment procedures and increase the quality and effectiveness of the internal financial control system as a whole.

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