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Internal Control in the Insurance System.

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ABSTRACT

The article considers the new notions as transparency and nonlinearity determine the modern insurance management. The article compares the internal control concepts and describes other components and principles of internal control organization in the insurance companies. A frame of administrative review and audit bring in the preservation of sharer holding and cost of an insurance company.

Keywords: insurance system, system of nonlinearity, internal control, control procedure, administrative review
JEL Classifications: P10, P40

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INTRODUCTION

Problem setting

Insurance system is a complex nonlinear system that concentrates the interests of the majority of citizens. Nonlinearity is a complex, ambiguous, non-deterministic behavior of economic subjects (Baymuratov 2005a). The nonlinear approach to the problem of the insurance system allowed the Director of the Research Institute of Finance Banking Management U.B.Baymuratov to form the following axiom: there is no way to manage stable and growing economy without a talented, healthy and protected person and without a strong economy there will not be a sovereign state. Indeed, Kazakhstan addressed to reform this important segment in the monetary and financial area after achieving independence (Baymuratov 2005b).

In our opinion, when any change in the system can lead to both positive and negative results, i.e., nonlinear relationship between exposure and manifestation of results takes place.

In the broadest sense, the essence of insurance belongs to one of the fastest growing areas of the financial infrastructure of the economy. The most important functions of insurance are to ensure the continuity of social reproduction, stimulation of scientific and technological progress, concentration of investment resources, and those are to meet the needs of a modern economy and represent the role of insurance as a powerful factor of progressive development of the economy of any country, including the Republic of Kazakhstan, making this kind of economic activity, such as insurance a strategic one. In contemporary conditions of functioning, guarantee for the insurance success of insurance organizations is meeting of the requirements of the insurance management.

Insurance management of economic activity is the harmonization of general and specific management functions. The order of management and management style (authoritarian, cooperative, mixed), are defined by the presence of a developed system of sales of insured products (branches, agencies, offices), by a variety and capacities of other activities not prohibited by the law. Lead the method up of such degree this the efficacious "administration" with dynamical formation serve uniform conceivable on equalize to check this which administrator can prefer (Smith and Fischbacher 2009).

Over the past decade, many insurance managers have recognized the need of "a new control", not by the group methods, but by a thoughtful approach to the construction and development of the insurance management.

Recent research and publications analysis

Many works of Research of internal control T. A. Ratcliffe and C. E. Landes (Ratcliffe and Landes 2009) and other scientists.

The research objective

The main objective of internal control is protection of the interests of an organization and its partners by monitoring compliance of activities of employees of an insurance company to law, normative acts and professional standards, ensuring an appropriate level of reliability that corresponds to a type and scale of business operations and minimization of risks of insurance activity.

Key research findings

The internal control, in general, comes down to two interpretations: in the narrow sense it is one of the stages of the management trial, and in a broader sense it is an integral part of the management system of an insurance entity, consisting of number of elements.

The control can be determined differently: as tool, factor, form, element, function, type of activity, system, feedback, condition, regulator, guarantee, event, institute, method, legal authority, what does not reflect the striving to give generalized meaning of economical control and is a result of approach to review of

its content from the view point of the interests of representatives of various scientific directions: philosophy, theory of management, policy, law and others.

International standards of financial report determine control as a “possibility to manage financial economical policy in order to receive profits from its activity” (MSFO 2006).

In glossary of terms to international standards of audit this term has the following meaning: “system of internal control – processes that are developed, implemented and realized by persons who have managing authority, management of a subject and other personnel for the purpose of provision of rational assurance in achievement of purposes of subject in the context of reliability of financial report, efficiency and productiveness of operations, as well as observance of legislation and normative acts”(Beluha 2000: 34).

The main goal of internal control is the protection of interests of organization and its partners by way of control over the observance of legislation, normative acts and standards of professional activity, provision of a proper level of reliability that corresponds to character and scale of economical operations and minimization of risks of insurance activity by the employees of insurance organizations.

Assessment of the system of internal control is outside the framework of those questions that are related directly to functions of system of accounting and consists of the following components:

Control environment; process of assessment of risks by auditing subject; information system related to preparation of financial reports; control actions; monitoring of control methods (Dusembayev 2012: 409)

The control should be considered on various levels of functioning of insurance subjects. On the level of management of insurance unit the external control that is realized by external insurance subjects of management related to organization (agencies of the government, consumer, creditors) and internal control that is realized by subjects of the insurance company itself (owners, administration, personnel) can be separated. The efficiency of functioning of insurance subjects (economic units) depends on efficiency of internal control, and the efficiency of functioning of insurance subjects in total is one of conditions of efficiency of all production activity. In modern conditions the internal control as a managing function should be realized on all levels of management.

Control in management should be considered by three directions that:

- Control as constant and goal-oriented activity of the directors is one of the main managing functions, i.e. control for activity;
- Control as a finishing stage of the process of management that has the principle of feedback;
- Control as integral element of the process of management that functioning during process of activity from its beginning until ending of the managerial solution.

The internal control is one of the main functions of management and represents system of permanent observances and check of work of organization for the purpose of evaluation of justification and efficiency of made managerial solution, revelation of deviations and unfavorable situations, timely notification of management for making of decisions on elimination, decrease of risks of its activity and its management. In such manner the internal control – is a form of feedback by way of which the violations are revealed in time, the managerial solutions are taken in time in order to avoid negative events in the activity of insurance subject.

The main characteristics of internal control are: one of the main functions of management; system of permanent observation; complex of security measures; process that is realized by management and personnel. By noting the meaning of internal control in the system of management it should be noticed that internal control is inseparably connected to the system of accounting and financial report of insurance organizations. The control is presented on all stages of accounting. The control in form of inventory presents the main element of method of accounting. In combination with documentation the inventory composes methods of primary grouping of facts of economical life. Accounting accepts only those facts which went through preliminary check. The accounting has the leading role, and control was the method of accounting that provided the correctness of revelation of facts of economical life. The reality of revelation of facts of economical life in accounting is confirmed by data of inventory.

In such manner the internal control inseparably connected with the system of accounting of financial and economical activity of insurance subject, because plays the role of a kind of mechanism that is realizing within the framework of system of accounting on the basis of such tools as plans, orders, limits, norms, cost sheets and etc. The control is a mechanism of execution of plans in accordance with data of accounting from one side and from another side the data of accounting is a basis for acceptance of new plans execution of which is confirmed by means of control, because it is known that the “effective control should precede to economical work, accompany it and follow it” (Besta 1893).

By analyzing the evolution of development of accounting and control, the conclusion that the control was originated in depth of accounting and initially existed as method of book-keeping can be made. So, for example according to opinion of A.Z. Popova “the main method of computation science is independent control or in other words – independent observation” (Popova1904). In such manner the accounting had the leading role, and control was the method of accounting that provided the correctness of revelation of economical operations. In future the development of control allowed it to go outside the border of traditional system of accounting because of what the connection between accounting and control had been changed totally. I.A. Sholomovich stated that “the accounting is an integral part of system of control at the enterprise” (Sholomovich 1938). From this moment control was reviewed as system that has its own subject, method and methodical procedures. And the accounting received secondary role – generalization of information about activity of organization for the purpose of realization of control activities and it begins to be considered as a part of the control system.

As a result of study of interrelation between accounting and control the following conclusions were made:

- Accounting is a base that traditionally forms and generalizes all accounting information, and the control in specific cases could not work without it, because the result and content of number of economical processes could be controlled only upon presence of accounting information about data of the processes;
- During realization of incident to accounting goals the control of economical processes that are taking place in organizations is realized, that is conditioned with necessity of execution of one of the requirements presented to the system of accounting – is its authenticity.

It can be said that the accounting includes separate control functions, the execution of which is promoted achievement of purposes and goals standing in front of the control system and is promoting achievement by economical subject of its goals.

The internal control that is appeared in forms of: accounting control; managerial control; inventory control; auditorial control; internal audit is more effective for economic evaluation of the activity of economical subject.

Along with determination of forms if internal control, its subjects and objects, the more sufficient is determination of objective of internal control.

The selection of type of internal control depends on: organizational and managerial structure; organizational and legal type; direction of activity; advisability of the scope by control of various sides of activity; relation of management of the insurance subject to control.

The object of internal control is factual presence of resources of economical subject, its condition, aspects of its functioning.

Subject of internal control of organization – is a worker or participant (owner) of insurance organization that executes control actions upon execution of laid on him obligations or only on the basis of corresponding rights.

All subjects of internal control will be advisably to divide on following levels from angle of significance in combined control action (Figure 1).

Figure 1: Division of subjects of internal control by levels

Subjects of internal control	1 st level	Participants (owners) of organization who realize control directly or indirectly, i.e. with help of independent experts including external auditors.
	2 nd level	Subjects, obligations of which not include control but by virtue of production necessity they also execute control functions
	3 rd level	Subjects execute control functions for realization of those functions that are attached to them directly (workers of planning and economical departments, human resources department).
	4 th level	Obligations of subjects include not also control but other functions (administration and management personnel, personnel that serves computer systems, workers of accounting department, services of commercial and physical security).
	5 th level	Functional obligations of subjects include only realization of control (workers of department of internal audit and members of revision commission)
Source* was made by author		

By formulation of the objective of internal control the first role is given to safety of assets of insurance subject (material, labor and financial resources) for purpose of prevention of negative events in activity of insurance subject and acceptance of timely decisions in management system. In this case the control is considered as:

- Control that is focused on adequacy of organizational events on provision with physical security of assets;
- Control for a subject of assurance of financial and economical operations, paying capacity and good faith of contractors on contracts, good of faith of managers who accept decisions on these operations.

The interrelated sub-goals flow from the main objective of internal control. The achievement of stated objective is achieved by provision of adequate level of fullness and accuracy of primary documents and quality of primary information, effective system of accounting: presence, fullness, arithmetical accuracy, posting of accounts, formal resolution, temporary certainty, presentation and revelation of data in the accounting, rational and economical use of all types of resources what will lead to growth of productiveness of labor, decrease of expenses of production and appeal, improvement of financial and economical results of the activity of the insurance subject.

System of internal control represents accumulation of controlling authorities who execute control procedures in favor of some or other groups of users of economical information. Controlling procedures are realized in the insurance subject for purpose of efficient management, the basis of which is a control of execution of their obligations by all employees of the insurance subject.

Recently the significant role in the system of internal control goes to managing personnel for the purpose of research of reserves of increase of efficiency of the activity of the insurance subject. In this case the managing control acts as function of managing accounting. From the viewpoint of managing accounting the system of managing control is the complex solution of tasks on management of incomes and expenses, money flows, circulating funds and capital investments, i.e. financial activity of insurance subjects.

The control in managerial accounting essentially defers from control function of accounts department. The legality of executed operations, correctness of performance of primary documents and deals are controlled by accounting, but only by means of good position of accounting the possibility of appreciations and overpayment at the moment of the realization of expenses can be prevented. In managerial accounting the control is primarily aimed at perspective. There are the control of correctness of selection of the goals of expenses and results of the activity, control of internal and external limits that impede to insurance subject to achieve made goals, control of budgets, making and execution of cost sheet of income and expenses. The current control in accounting for management includes monitoring of external and internal environment for determination of possible influence on production and economical activity of insurance subject. Only following control in the managerial accounting is somewhat alike to accounting. It is realized by revelation or calculation of deviations of actual values from planning and analysis of these reasons of deviations.

The modern meaning of managerial accounting in area of management entered to the theory and practice as a new concept of information and management – «managing control» («management control» in USA, «controlling» in Germany, «control dejection» in France). For the first time the essence of this meaning was defined by American scientists as a process by means of which the directors provide effective and resultative use of resources for achievement of purposes of organizations. As it can be seen in given definition two meaning “accounting” and “management” are merging, but other specialists are adhering to an opinion of C. Drury: control – is a measurement and information and the management – are first of all actions (Druri 2002). In other words during process of control the information which helps to reveal deviations from planned features is being formed, and during process of management the actions on elimination of occurred deviations and achievement of planned goals are being realized. In point of fact it is a single process because revelation of deviations without taking any managerial actions is irrational and contradicts to foundational principle of managerial accounting “expenses/profits”. Accounting information in the system of management control plays important role but not only one role. It is “only a part of the ring” (Entony1993) of system contour because revealed deviations by themselves do not change the activity of enterprise. Changes occur as a result of goal-orientated actions that’s why the management control includes two functions: accounting and information and correcting (managerial).

Common conclusion in the meaning of managerial control comes to two of its interpretations: in a narrow sense – it is one of stages of processes of management and in wider sense – it is an integral part of the system of management of insurance subject consisting of the number of the elements.

Functioning of the economical subjects under conditions of global economic crisis requires active sequential implementation to the system of management of newest achievements in the organization of accounting and system of internal control.

CONCLUSIONS

According to the study, we can conclude that, in accordance with the foreign practices and research (Sharma 2002), many of the problems of insurers are the direct cause of ineffective method check-out – a reliable frame of internal check and audit contributes on the preservation of stock owner holding or assets of an insurance company, and also plays an important role in controlling risks. All studied international standards and guidelines are based on a general principle, which suggests that adequate governance in insurance subjects requires a general frame administrative review or audit.

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