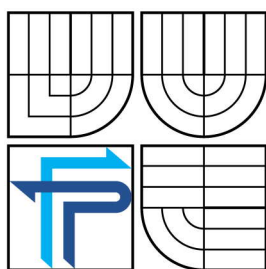


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FINANCIAL REPORTING QUALITY CONTROL FOR INTERNAL CONTROL IMPLEMENTATION

KONTROLA KVALITY FINANČNÍCH VÝKAZU PRO ZAVEDENÍ SYSTÉMU VNITRNÍ KONTROLY

DIZERTAČNÍ PRÁCE
DOCTORAL THESIS

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BRNO 2009

ABSTRACT

Though at the enterprises the estimation of a financial condition is annually, it is necessary to develop, to improve constantly and to evaluate the system of the internal control, necessary to develop a technique of the reporting quality estimation of the enterprise specially for the certain enterprise in view of all features, to take advantage of statistical data and to draw corresponding conclusions, to make constant monitoring. The purpose of development of the mechanism - detection of deviations of data in the reporting from actual results of activity, definition of clauses causing distortion of a real financial condition of the enterprise, revealing of size of influence of the given distortions and qualities of the reporting as a whole on decision-making, and also revealing of the reasons causing these deviations and distortions, and development of recommendations on corresponding correction separate directions for improvement of quality of the reporting.

How can high reporting quality and internal control create an advantage? In survey of institutional investors is reported that investors apply a penalty if they believe a company's internal control to be insufficient. Sixty-one percent of respondents said they had avoided investing in companies and 48% had de-invested in companies where internal control was considered inadequate. As additional support, they study went on to report that 82% of respondents agreed that good internal control was worth a premium on share price. These institutional investors are pushing for greater transparency on risk issues and related internal control efforts. Simply put, an organization's ability to implement and maintain a leading-class control framework can create competitive advantage in today's market.

A system of the financial reporting conducting with strong management, quality control and good legislative base is the key factor of economic development. The trust of investors in the financial and not financial information is based on strong Internal Control, high-quality standards of the financial reporting, audit and ethics, thus, standards and Internal Control play the leading part in assistance of economic growth and financial stability in the country. Nevertheless, every company meets the problems of implementation of the internal control. Among them there can be problems in labor qualification, legislation and so on. It is also necessary to examine the successful experience at the micro level.

KEY WORDS

Internal control

Financial reporting

Qualitative characteristics of financial reporting

Quality reporting

Influencing factors

Information filters

Financial reporting quality control

BIBLIOGRAPHIC CITATION

Gafarov T., *Financial reporting quality control for internal control implementation*.
Brno: Brno University of Technology, Faculty of Business and Management, 2009. 148 p.
Ph.D. thesis supervisor Ing. Helena Hanušová, CSc.

CERTIFICATION OF DISSERTATION

I certify that the ideas, results, analyses and conclusions reported in this dissertation are entirely my own effort, except where otherwise acknowledged. I also certify that the work is original and has not been previously submitted for any other award, except where otherwise acknowledged.

Signature of Candidate

Date

ENDORSEMENT

Signature of Supervisor

Date

ACKNOWLEDGMENTS

I would like to acknowledge the assistance of many people who provided help, support, and encouragement, enabling me to complete my PhD dissertation. In particular, I would like to acknowledge the contribution of my principle supervisor, Ing. Helena Hanusova, CSc who guided and encouraged me from the beginning and throughout my whole PhD candidature, as well as my associate supervisor associate professor Galina Bushmeleva, CSc. Other friends and colleagues in the Faculty of Business and Management and particularly in the Department of Finance provided invaluable assistance, support and feedback.

Special thanks to Ing. Martin Pernica, who helped me at many critical stages of my research and to Ing. Josef Polak and Ing. Jakub Tabas, whose friendships helped me greatly on completion of this dissertation.

Finally, I wish to express my gratitude and love to my family and to Agafonova Ekaterina for their unreserved love, support and encouragement. The courage and determination they taught me have made my life so wonderful.

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INTRODUCTION

Today's organizations are operating and competing in an information age. Information has become a key resource of most organizations, economies, and societies. Indeed, an organization's basis for competition has changed from tangible products to intangible information. More and more organizations believe that quality information is critical to their success. However, not many of them have turned this belief into effective action. Poor quality information can have significant social and business impacts. There is strong evidence that data quality problems are becoming increasingly prevalent in practice. Most organizations have experienced the adverse effects of decisions based on information of inferior quality. It is likely that some data stakeholders are not satisfied with the quality of the information delivered in their organizations. In brief, information quality issues have become important for organizations that want to perform well, obtain competitive advantage, or even just survive in the 21st century. In particular, accounting maintains and produces the data used by organizations to plan, evaluate, and diagnose the dynamics of operations and financial circumstances. Providing and assuring qualitative data is an objective of accounting. With the advent of financial reporting quality, the traditional focus on the input and recording of data needs to be offset with recognition that the systems themselves may affect the quality of information. Indeed, empirical evidence suggests that information quality is problematic in financial reporting. Accounting information quality is concerned with detecting the presence or absence of target error classes in accounts.

Still publications on problematics of the reporting quality in the majority are reduced to system of maintenance of standards of the financial reporting. It has been caused by bankruptcies Enron, WorldCom, Parmalat, which distortions of the financial reports have reached the unprecedented size.

Most of the information system researches into data quality focus on the theoretical modeling of controls and measurements. For example, there is a research on the impact and propagation of errors throughout information systems. Other studies focus on editing data and input controls. Many studies in AIS have focused on internal controls and audit. However, few studies have attempted to understand what causes the difference in information quality outcomes, and what should be done to ensure high quality accounting information and how to measure this quality. Therefore, there is lack of knowledge of the factor's estimations for

information quality in Accounting that can assist organizations to ensure and improve accounting information quality.

One of the major directions of accounting and the control development is a problem of the continuous scientifically-proved tracing of current processes at the enterprise, external and internal factors, their estimation and forecasting of influence on the financial reporting quality.

1 THESIS TASKS AND PURPOSES

1.1 Problem introduction

One of the major condition of economy and its functioning elements such as entities, infrastructure and authorities is a presence of the economic information which satisfies to a number of requirements to make the valid decisions.

It is theoretically and historically proved, that accounting in the form of the accounting reporting (further - the financial reporting) can give such information. Accounting forms information on a financial position of the entity, financial results of its activity and movements of money resources for satisfaction of the information users requirements. Requirements to the accounting information are fixed not only in the international standards and concepts, but also in local legislative, and standards confirmed by the state.

It is generally accepted, that mistrust to the financial reporting brakes market development of investments. Foreign, and also internal investors not always wish to become shareholders of the enterprises. Poor quality of the financial reporting creates a barrier to hit the population money on a securities market. On the one hand, that brakes investment processes in the country, and on the other - increases a inequality, doing the income to be the exclusive privilege of rich people who dispose large share holdings and often have access to the additional information which has been not mentioned in the public financial reporting.

Today accounting systems and the internal control (further - IC) concepts are subjects of constant changes. Continuous reforming of the European, Russian and American systems of the accounting is observed. Especially the Russian accounting worries the difficult period of reforming. Thus usually due value and attention is not given to qualitative characteristics of the financial reporting

The decision of these problems is carried out intuitively without a support on scientifically proved systems, and has a formal character. At such approach it is difficult to estimate objective a condition of accounting process, to define tendencies of its development, and to set up necessary corrective amendments in process of the accounting, reporting and control.

One of the major directions of accounting improvement is a problem of the continuous scientifically-proved tracing of current processes in the enterprise, external and internal factors detection, their estimation and forecasting of influence on the financial reporting quality.

The present dissertational research is devoted to implementation of the financial reporting quality control, as a tool of the managers who will use it for supervision and estimation of the financial reporting quality.

Quality assurance, monitoring and control of quality of the financial reporting - insufficiently known a theoretical and practical field of knowledge. On analogies to financial management and financial monitoring, tax management, quality control has arisen originally in the economic environment, i.e. in practical activities, and only subsequently there were attempts of theoretical generalization and development of this field of knowledge.

At the same time most of the publications targeting on a problematics of report's quality were reduced to systems of maintenance of the financial reporting standards. It was reason of Enron, WorldCom, Parmalat bankruptcies. In the USA reaction to the given scandals was acceptance of the Sarbanes-Oxley Act¹ (further - SOX) in 2002, the exacting control over the financial reporting. The eighth directive of the European union of the corporate law also has undergone to change.

The comparative youth of this theoretical and practical field of knowledge, and also specificity of national legislations and the impossibility of foreign experience transformation in the field of quality of the financial reporting, distinction of experience, and also absence of the fact of wide spread of IFRS explains lack of the economic literature. The uniform approach to this function of intrafirm management in available publications is absent, and there is no still a conceptual device of discipline.

1.2 Ph.D. thesis purposes and tasks

At the enterprises the analysis of financial and economic activity showing an available financial condition of the enterprise is periodically carried out, but frequently there is no estimation of the financial reporting quality, the control and monitoring is not existing. The

¹ *Sarbanes-Oxley Act*. 2002. < http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=107_cong_bills&docid=f:h3763enr.tst.pdf >

dissertational work purposes is set: to introduce the parameters of the reporting quality in a control system of the enterprise and to develop a technique of control. For achievement of an object it is necessary: to define the concept of quality of the reporting; to reveal features; to study theoretical bases of the quality estimation; to lead the analysis; to develop recommendations on introduction of qualitative parameters in control system of the enterprise, for its efficiency, to develop the control technique.

Object of the research is managerial activity at the enterprises. Subject of the research is the internal control as a tool of improvement of accounting, analytical and financial economic processes of the industrial enterprise.

The research aims are generalisation of theoretical and practical knowledge, working out of scientifically proved recommendations for organizational-methodical maintenance of quality assurance of the financial reports in the enterprise and creation the concept of the quality control.

According to the purpose following tasks have been defined:

- to specify the definitions of the financial reporting and internal control;
- to show the necessity of the self-control of reporting quality;
- to develop the concept of financial reporting quality control of the enterprise;
- to define a place of the control in structure of operation of business;
- to define factors influencing on the financial reporting quality;
- to specify concept of the financial reporting quality control;
- to reveal sources of a supply with information of the control;
- to create a technique of carrying out the financial reporting quality control of the enterprise and to approve it in the enterprises;
- to formulate generalizations of the control concept and in this connection to develop scientifically-practical recommendations on improvement the managers decisions.

Though the estimation of a financial condition is constantly made, it is also necessary to develop, constantly to improve and estimate the system of the internal control. It is necessary to develop a technique of estimation of the reporting quality specially for the certain enterprises in view of all features, to take advantage of statistical data and to draw corresponding conclusions, to make constant control.

Thus, reporting quality control can be named as the mechanism of the constant supervision over the major current processes of financial and economic activity, and estimation of their influence on the financial reporting quality in conditions of constantly varying external and internal environment. The purposes of development of the mechanism of control are: constant detection of deviations of data in the reporting from actual results of activity, definition of clauses causing distortion of a real financial condition of the enterprise, revealing of size of influence of the given distortions and quality of the reporting as a whole

on decision-making, and also revealing of the reasons causing these deviations and distortions, and recommendation development on corresponding correction for an improvement of the reporting quality.

In addition, three research hypotheses were formed to help answer the research questions. Those hypotheses are listed below:

Hypothesis 1. There are factors influencing on financial reporting quality which are possible to measure

Hypothesis 2. It is possible to measure the financial reporting quality characteristics

Hypothesis 3. The internal control implementation and evaluation can be and should be based on financial reporting quality control.

1.3 Research approach and methodology

Theoretical and methodological basis, and also information base of research are made by proceedings of the Russian, Czech and foreign scientists on an investigated problem, official documents and legislation of The Russian Federation, The Czech Republic, EU, and The USA.

Empirical base of the thesis includes data got during the research according to the Internal Grant Agency of Business and Management faculty Brno University of Technology N AD179001M2.

Induction and deduction were used to specify the key definitions, the system analysis and synthesis were used for concept formulation, interrogation, supervision, questioning were used for influencing factors study.

The financial reporting quality control technique is developed with use of economic-mathematical methods. In a final part of work modeling and approbation of a technique by creation of imitating model and the system of the quality reporting expert evaluation are made on the base of fuzzy logic, hierarchy analysis and on a base of qualimetry.

And also to make the analysis and synthesis of the received results of experiment the methods of the comparative analysis are used. And to generalize, to compare results of supervision were used statistical and mathematical methods.

The experiment is approbated in an industrial and audit enterprises of Udmurt republic, Russia.

1.4 Scientific novelty

Scientific novelty of research consists in the following:

1. The concept of the financial reporting quality is specified as a category of the economic information which is presented by set of the financial indicators and has quality characteristics

2. The necessity of allocation of such segment as an estimation of the financial reporting on conformity to requirements to qualitative characteristics is shown as an independent direction in system of the internal control and allows to estimate quality of the accounting (financial) reporting of the enterprises.

3. The influencing reporting quality factors were overviewed and their hierarchy were designated.

- The major factors influencing quality of the financial reporting are formulated, their hierarchy is designated, qualitative characteristics of the reporting on which there is an influence are defined;

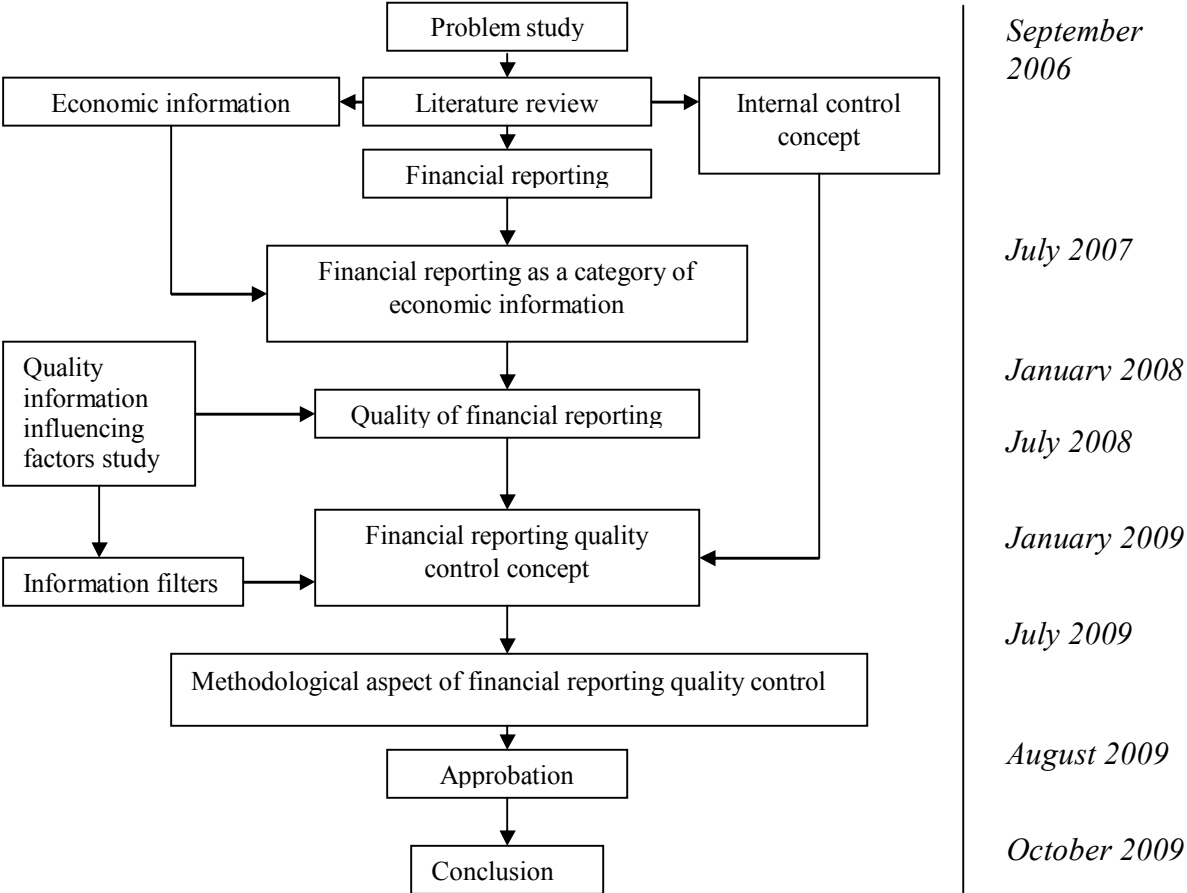
- Necessity of an estimation of internal factors influencing quality of the information - information filters is revealed, filters definitions are given and their essence is shown.

4. Techniques for an estimation of the factors influencing qualitative characteristics of the financial reporting, and also on quality of the reporting as a whole with use of fuzzy logic bases are offered, the documentation for an estimation is developed.

5. The methodical aspect to an estimation of quality of the financial reporting in a kind of the multicriterial characteristic uniting the major qualitative characteristics, giving in to the description by means of qualitative and the quantitative indicators defining the possibility of

its use for decision-making, as bases for process of Internal Control construction and constant improvement is worked out.

1.5 Time harmonogramm



1.6 The theoretical importance

The theoretical importance on the research termination can be that:

Necessity of allocation of such segment as a financial reporting quality estimation on conformity to requests of qualitative characteristics which is an independent direction in system of the internal control is reasonable and allows to evaluate quality of the accounting (financial) reporting of the enterprises.

Submission is given and the hierarchy of factors influencing quality of the financial reporting is designated.

Techniques for an estimation of the factors influencing qualitative characteristics of the financial reporting, and also on quality of the reporting as a whole with use of bases of fuzzy logic is offered, the documentation for an estimation is developed.

The methodical aspect to the financial reporting quality estimation as a kind of multicriteria characteristic uniting the major qualitative characteristics for its use on decision-making, as bases for process of implementation and constant internal control improvement is offered and can be used in the enterprises.

And also theoretical positions, recommendations and work conclusions can be used for courses “Audit”, “Analysis”, “Operation of business”, “Financial accounting”, “Accounting”, “IFRS”, etc., and also for study-methodical materials.

1.7 The practical importance

The practical importance of research consists that identifying the influencing factors could enhance the ability of accounting to gather data, process information and prepare reports. Outcomes of this research will contribute to the body of knowledge both in Accounting Information System and Internal control, and it may benefit other research into these areas. For example, it can help arouse the awareness of data quality issues in AIS field, and to make it possible to establish the linkage of the identified factors with the existing data quality dimensions for outcomes assessment. Thus, understanding how these factors affect financial reporting quality may be useful to practitioners. Focusing on those factors that are more critical than others will lead to efficiency and effectiveness management procedures. In brief, the results from this research are likely to help organizations’ top management, accountants, and IT managers obtain better understanding of financial reporting quality issues.

1.8 Approbation and introduction of results of research.

Main results of research were reported and discussed on faculty meetings «Accounting and the economic activities analysis» in the Izhevsk State Technical University, at the European international scientifically-practical conference in Brno, on international online-video conference between Izhevsk State Technical University and Technological University

of Brno, at annual scientifically-methodical conference MendelNet (2009), and also at carrying out of seminars and a practical training for foreign students. Experiment has been spent in one industrial enterprise and audit company of the Udmurt republic, Russia.

1.9 Volume and dissertation structure.

The dissertation consists of the introduction, four heads, the conclusion, the list of the used literature and appendices. Total amount of the dissertation pages of the text is 148, including 37 tables, 17 pictures. The literature list consists of 112 names of works of domestic and foreign authors, and also statutory acts.

2 THE THEORY OF INTERNAL CONTROL AND FINANCIAL REPORTING QUALITY ASSURANCE.

2.1 The financial reporting as an economic information needed for decision-making

2.1.1 Economic information

The significance of the information in our modern life and activity of each modern person is great. The role of the information for the successful decision and specific targets in management of an enterprise is great. It is possible to avoid errors in decision-making to the only one who is good guided in an information space of an enterprise and who does possesses the quality information.

The category “information” occurs from Latin “informatio” that means an explanation, a notification, an exposition. From items of materialistic philosophy the information is reflexion of the real world by means of data (messages). The message² is a form of submission of the information in the form of speech, the text, images, figures, schedules, tables, etc.

In Ushakov's explanatory dictionary³ the information is understood as the message informing on a state of affairs or about someone's activity, data on something.

The Russian legislation define the information as data on persons, subjects, the facts, events, the phenomena and processes irrespective of the form of their submission⁴.

The modern economic dictionary⁵ gives following definitions of the information – 1) any message on something. 2) the data, the significances of economic indicators which are objects of storage, processing and transfer and used in the course of the analysis and decisions-making in management. 3) one of kinds of a resource used in the economic

² Simonovich S. V. *Informatika. Bazovyi kurs*. 1999. p 640.

³ Ushakov. N. *Tolkovyi slovar' russkogo yazyka Ushakova*: Gos. In-t «Sov. Incikl.»; Gos. Izd-vo inostr. i nac. slov., 1935-1940.

⁴ Federal'nyi zakon RF N 149-FZ : 27.07.2006 *Ob informacii, informacionnykh tekhnologiyah i o zashite informacii* // Rossiiskaya gazeta. – 2006. № 165.

⁵ Raizberg B. A., Lozovskii L. Sh., Starodubceva E. B. *Sovremennyi ekonomicheskii slovar'*. 5th ed. 2007. p 495.

processes which reception requires expenses of time and other resources. In this case these expenses should be included in production costs.

Thus, the information is data (the messages, facts, showings, record) irrespective of the form of their submission about persons, subjects, the facts, events, the phenomena and the processes, which is necessary for decision-making.

But the economic information is necessary for management of an enterprise. The explanatory law dictionary⁶ defines that the economic information is the information on processes of production, distribution, an exchange and consumption of the material benefits occurring at macroeconomic and microeconomic levels. Includes analytical, planned, statistical, industrial-technological, commercial, financial, social, scientific, administrative information.

The big Soviet encyclopedia⁷ gives the economic information as a data, messages, documents on an economic condition of company, including state economic policy, about its level and production structure, about movement of work, the goods, the capital, about incomes of the population, budgetary and tax relations etc. It is possible to allocate the economic information as the statistical information, productive and economic, commercial, business, bank, scientific etc.

The modern economic dictionary makes following definition: «the economic information - the information on processes of production, distribution, an exchange and consumption of the material benefits occurring at macroeconomic and microeconomic levels.

Borisov A.B.⁸ considers the economic information as the information on public processes of production, distribution, an exchange and consumption of material benefits

The Economic mathematical dictionary⁹ makes following definition of the economic information - the data reducing uncertainty and the defect of knowledge supplementing presentation about social and economic processes, both of production sphere, and of non-productive sphere at all levels and in all bodies. The economic information displays the facts

⁶ *Tolkovyi slovar' SPS «Garant»*. [legislative database]

⁷ Prohorova A.M. *Bol'shaya sovetskaya enciklopediya*. 3rd ed. T 1: «Sov. enciklopediya», 1969-1978.

⁸ Borisov A.N., Korneeva G.V. *Lingvisticheskii podhod k postroeniyu modelei prinyatiya reshenii v usloviyah neopredelennosti //Metody prinyatiya reshenii v usloviyah neopredelennosti*. Riga, 1980. № 7. p. 4-11.

⁹ Lopatnikov L.I. *Ekonomiko-matematicheskii slovar': Slovar' sovremennoi ekonomicheskoi nauki*. 5th ed. 2003. p. 520.

of economic activities by means of system natural and cost indexes and, as a rule, is transmitted and processed in the form of the signs fixed on various material carriers. Set of the signs used for an exchange of the economic information in a certain economic system, forms language of the economic information.

Hence, it is possible to draw from the definitions a conclusion that the economic information (just the information on a microeconomic level further will be considered, i.e. in an enterprise context) – is a basis for the person, making the decision.

It is necessary to distinguish the economic information from «the economic data» which represents display of the economic events which have been written down in certain language on concrete material carriers (the indicators which have been written down in documents, texts or tables), but not connected with a certain problem or the consumer. In economy the information is understood as the data which define expectations and a choice of individuals. Thus, in the given work it is necessary to understand that the economic information is the messages, showings, value of economic indicators, messages, documents on an economic condition of the enterprise, and also its activity, which are the objects of storages, processings and transfers and used in the course of the analysis and working out of economic decisions in management which define the expectations and a choice of users.

In a turn of the economic information the greatest relative density is borrowed with data of the control and analytical accounts (inside of the enterprises), the transport and bank documentation (in a turn between the enterprises), the accounting and statistical reporting, the scheduled and normative documents, given operative management. According to various inspections, an annual interfarm turn of the fixed economic data within the limits of the industrial enterprise can be from 50 up to 2000 thousand documents (3,5-100 million parameters). The external turn (volume of entrance and target data) industrial enterprise is made approximately with 100 thousand documents and 1000 thousand parameters a year, including the transport bank documentation makes 80-90 % on number of documents and 40-50 % - on number of parameters. The industrial enterprise - 60-80 thousand parameters for a year represent the statistical and accounting reporting on the average volume¹⁰.

Vahrushina M. A. considers that if to define significance of an accounting information at decision-making it constitutes of management accounting about 20-30 %

¹⁰ Prohorova A.M. *Bol'shaya sovetskaya enciklopediya*. 3rd ed. T 1: «Sov. enciklopediya», 1969-1978.

from all information, 40-50 % are constituted by the information of the financial accounting, and other part is necessary on an analysis share¹¹.

This citation confirms an urgency of the economic information in managerial process. It is visible from the aforesaid analysis that strict classification of the economic information does not exist. Information can be statistical, productive and economic, commercial, business, tactical, bank, exchange, referral (including about taxes, the prices and tariffs), scientifically-economic, standard (regulating legal relations in economic sphere), etc. The clear boundary between the mentioned kinds of the economic information is absent. It is expedient to notice that in various kinds of the economic information the accounting information has the greatest weight.

2.1.2 Accounting information

It is considered that the economic information can be classified on management functions, in an occurrence place, on degree of stability and to other signs. Having considered classification offered by T.P. Karpova¹², S.N.Shirina¹³, N.M.Blazhenkova¹⁴ (Karpova, 2003, Shirina, 1999, Blazhenkova, 2004) and taking into account that on the majority of the enterprises information requirements are approximately identical and also grouping methods coincide, it is possible to present classification of the economic information in the form of picture 1.

The accounting information is divided into groups: tax, financial, managerial. The information of each kind can be generated in the accounting system.

Different authors give various definitions of the account:

- Accounting is art of records, classification and generalization of accounts by registration in monetary units of bargains and events which have, at least, in any part, financial character, and also is interpretations of the received results¹⁵;
- According to the Russian Federal act "About accounting" Accounting represents the ordered system of the gathering, registration and information generalisation in money

¹¹ Vahrushina M.A. *Buhgalterskii upravlencheskii uchet: uchebnik dlya studentov VUZov, obuchayushihnya po ekonomicheskim specialnostjam*. 5th ed. 2006. p. 570.

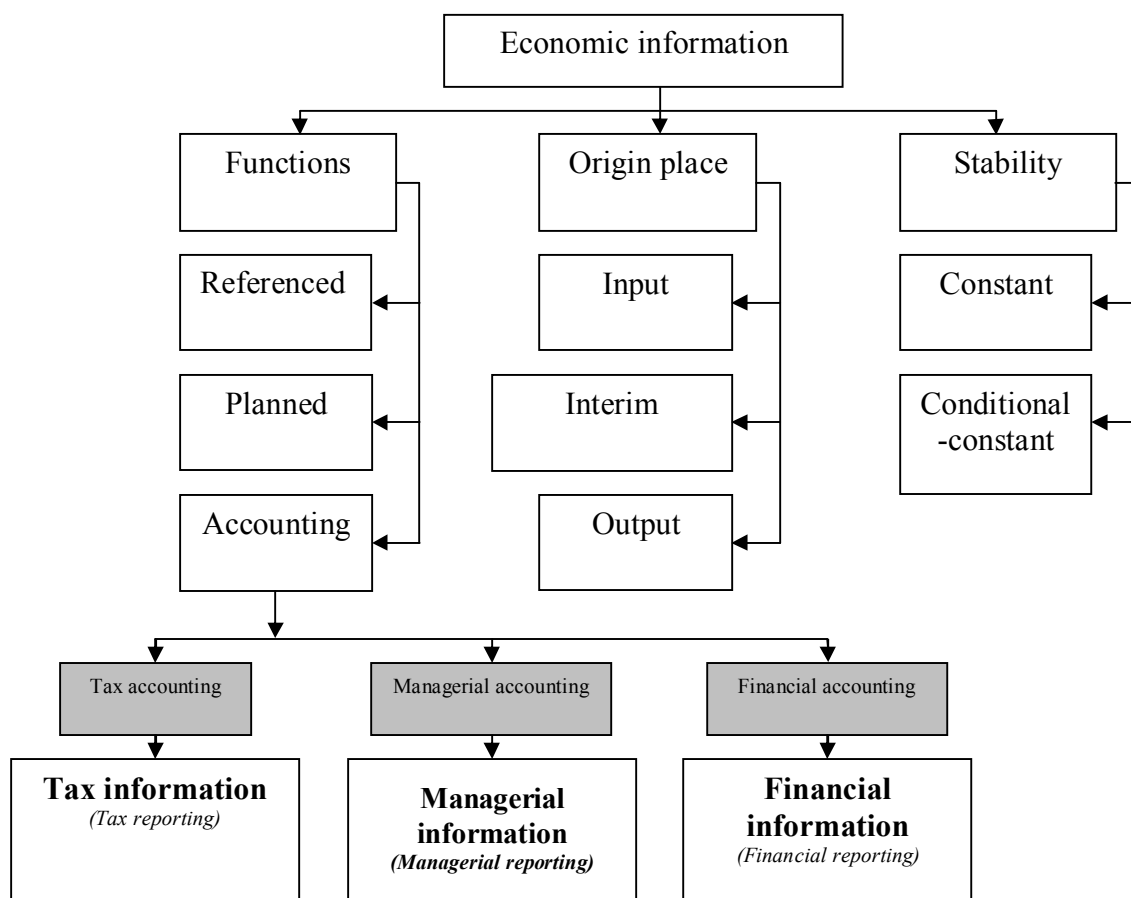
¹² Karpova T.P. *Upravlencheskii uchet : uchebnik dlya VUZov*. 2003. p 350.

¹³ Shirina S.N. *Informacionnoe obespechenie formirovaniya upravlencheskogo ucheta (Na materialah predpriyatii neftehimicheskoi promyshlennosti)*. CSc thesis: 08.00.12. Kislovodsk. 1999. p. 255.

¹⁴ Blazhenkova N. M. *Formirovanie podsistemystrategicheskogo upravlencheskogo ucheta na promyshlennom predpriyatii* : CSc thesis: 08.00.12. Izhevsk. 2004. p 159.

¹⁵ Fedosova T.V. *Organizaciya buhgalterskogo ucheta na predpriyatii*. Taganrog: TTI YuFU. 2007.

terms about property, obligations of the company and their movement by the contiguous, continuous and documentary registration of all economic operations¹⁶.



Picture 1. Economic information classification

In 1970 the American institute of accountants has declared that accounting function is to ensure the quantitative information, mainly financial character, about managing subjects with the purposes of use of this information for decision-making¹⁷.

The accounting helps the manager: a) to manage the processes for which he is responsible; b) to co-ordinate these processes on the company as a whole. The information is formed in the accounting for execution of following three main objectives¹⁸:

1. Drawing up of the periodic (routine) internal accounts and reports for administrative decisions. It ensures by the information the decisions accepted with certain degree of a regularity.

¹⁶ Federal'nyi zakon RF N 129-FZ: 21.11.1996 *O buhgalterskom uchete* // Rossiiskaya gazeta. 28.11.1996.

¹⁷ Fedosova T.V. *Organizaciya buhgalterskogo ucheta na predpriyatii*. Taganrog: TTI YuFU. 2007.

¹⁸ Horngren.Ch., Foster D., Datar S. *Upravlencheskii uchët*. 10th ed. 2005. p. 1008. ISBN: 978-5-94723-174-8

2. Drawing up of irregular (special) reports for administrative decisions. The information in them is formed for maintenance of decisions in situations which arise without certain periodicity or represent precedent.

3. Drawing up of the external reporting intended for investors, public authorities and other users. In some cases the information from the external reporting can be used by managers of the third-part organizations.

The information for each of the considered main objectives can be generated in an accounting system and is presented in the various methods. The ideal database consists of the numerous detailed micro complete sets of the information which can be used for maintenance of a set of problems. Accountants process the information with allowance for practical requirements of various external and internal users.

Internal users:

Chiefs of the enterprise – the persons quoted by the proprietors for realization of an operational administration, require the information on organization financial circumstances. Having such information, the management ensures efficient control for acceptance of corresponding administrative decisions.

Shareholders - on the basis of the accounting data evaluate, how much effectively the administration executes the functions, that is how much financially the organization successfully functions. Make the decision on sale of shares.

Investors – accept purchasing and selling of shares decisions, shares and other securities of the enterprise.

Workers of the enterprise – wish to have the information on a financial position and on incomes as the size of their wages depends on it, stability of jobs.

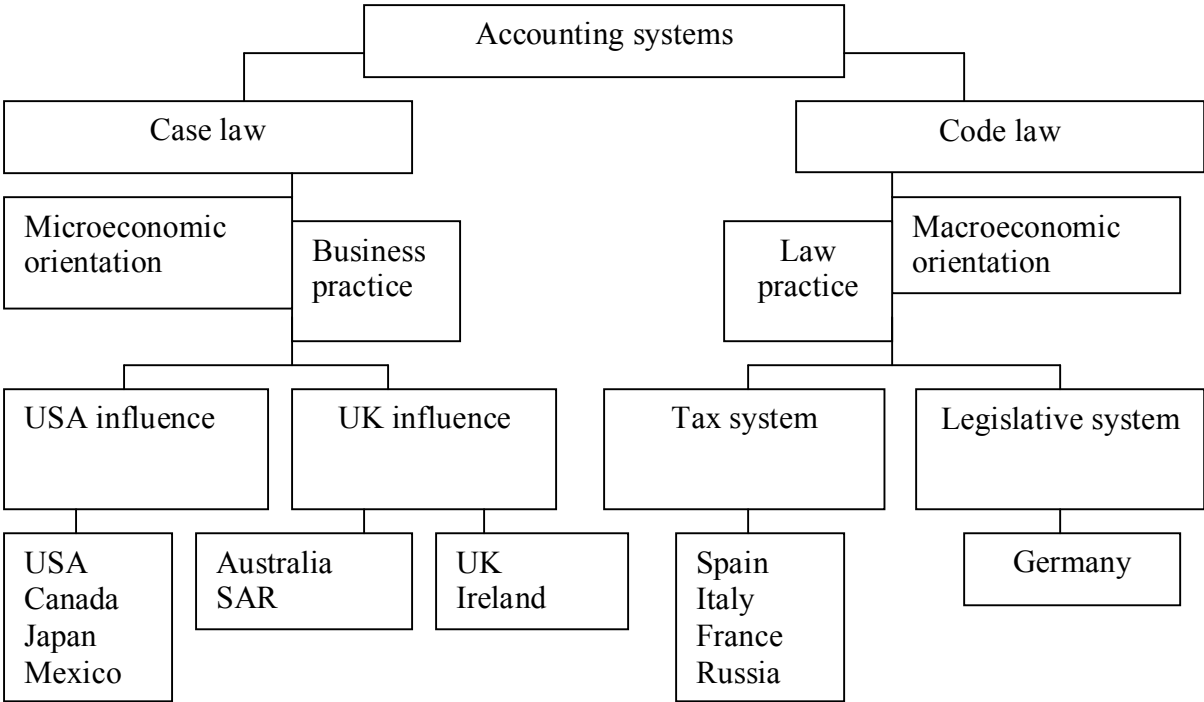
External users:

Commercial partners – suppliers it is necessary for them to know about solvency of the enterprise and buyers who should be assured that the enterprise is a reliable source of deliveries.

Creditors – banks and other lenders granting to the enterprise short-term and long credits, should be assured that it will be capable to redeem or pay off a loan and pay percents.

Taxing authority – it is necessary for them to have the information on profits of the enterprise and its property condition for the definition of the sums of taxes.

Having carried out the comparative analysis in accounting definition [26, 20, 11, 6, 124, 25, 13]. It is possible to draw a conclusion that there are disagreements between the authors in definition of kinds of the accounting which have been caused first of all by distinction of accounting models (see picture 2).



Picture 2. Accounting systems

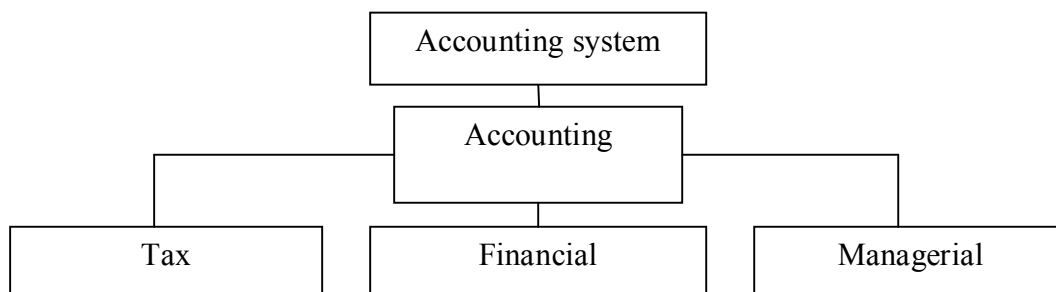
Undoubtedly, principal causes of distinctions of two models are:

1) economic (development of markets of capital, quantity of investors and creditors, inflation, the sizes and organizational structure of the companies, use of cross-border markets of the capital, the general educational level, legislative systems);

2) political and geographical.

“The greatest influence on formation of accounting systems was rendered by development and the size markets of capital, and also legal systems” [26, p.164]. The countries usually are divided on two big groups: the countries code law (continental, code) and the countries of the common (Anglo-Saxon, case law) (see picture 2).

Reforming of the Russian and Czech accounting according to IFRS has led to necessity of a recognition accounting on three blocks: financial Accounting, management accounting (managerial accounting) and tax accounting. In picture 3 constituents of registration system are shown.



Picture 3. Accounting branches

Comparative analyses made by Alborov R. A.¹⁹, and also which is presented in works of Bushmeleva G. V.²⁰, and also Needles B., and Anderson H.²¹ had been processed and added for more complete understanding of distinctions between branches of accounting. The received results are presented in the appendix 3. Main appointment of the financial accounting consists in formation of the reporting intended for external users. The financial accounting carries out measurement and registration on the accounts of economic operations and drawing up of the financial reporting on the basis of the accepted principles of the accounting. Industrial chiefs bear responsibility for reliability of the financial information represented to interested persons. Thus, managers are interested both in managerial, and in the financial accounting.

Before acceptance of the concept of the accounting development in the conditions of the economic market the accounting in Russia and The Czech Republic was considered as a unit without division into kinds.

However approchement with IFRS and development in integrated market relations have required from the state to change the attitudes to the accounting.

Today the special attention is given for studying of the international standards in the field of the financial accounting (the International Financial Reporting Standards, further -

¹⁹ Alborov R.A. *Razvitie ucheta i kontrolya v sisteme upravleniya sel'skohozyajstvennym proizvodstvom*. DSc thesis:08.00.12. Kazan. 2004. p.417.

²⁰ Bushmeleva G.V. *Monitoring v sisteme upravleniya predpriyatiem*.: Ros. akad. nauk. Ural. otd-nie. Int. ekonomiki. Ekaterinburg; Izhevsk. p. 60.

²¹ Needles B., Anderson H.R., Caldwell J.C. *Principles of Accounting*, 4-th ed. Houghton Mifflin Company, 1991.

IFRS) that allows to generate and prepare the financial reporting promoting reception of the economic information, necessary for investors and management. As a result the requirements to the quality of reporting and its structure constantly increase. Terms "the financial accounting" and "financial reporting" are used in IFRS and ISA (the international standards of audit) in relation to the external accounting and the reporting which is constituted on its basis. As modern standards of the different national accounting and audit are developed on the basis of IFRS and ISA, it is necessary to use terminology adequate to the international standards²².

The problems connected with formation of the financial reporting, definition of qualitative characteristics of the reporting, were recently object of attention of scientists-economists. Formation of methodology of the accounting, the analysis, management and the control have the significant contribution made by: Alvin A., Arens K., Loebbecke J. K., Benesh M., Burnham S., Gable C., Diamant D., Spencer K., Pickett H., Braiotta L., Switzer S., Pratt J., Fight A., Akinyemi J., Jin D., Willborn W., Myller, Montgomery R, Anthony R., Jones I., Hirsh B. and also Babaeva J.A., Bakanova M.I, Bakayev A.C, Balabanova I.T., Barngolts S.B., Armless I.W., Bychkova S.M., Burtsev V.V., Voznesenskij E.A., Guttsajta E.M., Danilevskij J.A., Dmitrieva I.M., Ivashkevich V.B., Kirjanova Z.V., Kondrakov N.P., Shouters A.B., Labyntsev N.T., Makarova L.G., Maksimova G.V. and others.

Thus, in the special literature the separate parties of formation of the financial reporting, internal audit and an internal control system are fully presented and studied. Nevertheless, a number of the aspects concerning quality assurance of the financial reporting require the further research. Questions concerning to the methodology and functioning of an internal control system, an estimation of factors influencing quality of the financial reporting are insufficiently studied.

Position is aggravated with existing rupture of direct interrelation between the general concept of management and principles of the accounting and the internal control which are accepted in Russia and The Czech Republic and the IFRS requests to the accounting. Development of the theory and methodology in a direction of quality evaluation of the financial reporting, conformity to qualitative characteristics and internal control system conditions, urged to promote more reliability of the accounting and (financial) reporting of managing subjects, efficiency of management.

²² Gracheva M.E. *MSA 100 i MSA 120 - interpretaciya i raskrytie* // MSFO i MSA v kreditnoi organizacii. 2007. N 1

Nowadays there are two systems of accounting often used at the international level: Generally Accepted Accounting Principles of the USA (further - GAAP US) and IFRS. Both systems are close to Anglo-American model of the accounting though there is a considerable quantity of essential distinctions.

Both these systems subdivide the accounting into three types (see picture 3). Thus, among the Russian experts there is an ambiguous understanding of English concept «accounting». Depending on a context it can be translated into Russian both as the financial reporting, and as book keeping. However in the first case English-speaking experts for whom accounting is a financial reporting synonym, usually put in concept "accounting" wider contents, than the Russian experts. Current record process is designated in English language by other term - «bookkeeping».

In process of strengthening of Anglo-American model influence on accounting development in Russia and The Czech Republic, it is possible to meet concept "financial reporting" even more often (for example, Laws of the Russian Federation "About Accounting"²³ and "About audit"²⁴). Accurate definition of this concept is not presented, however, from a context, as a rule, it is visible that terms "accounting" and "financial reporting" are understood as synonyms. In the Law "About audit" the concept "the accounting (financial) reporting" is used.

Let's notice that some attempts to conduct at least formal distinction between accounting and the financial reporting nevertheless are undertaken. In Russia the concept "accounting reporting" is traditionally used, however, with growth of influence of Anglo-American school of the accounting preferring the term "financial reporting" last began to be applied more and more widely in the domestic special literature and even in some laws. Essential distinction between these terms is not presented and, as a rule, difference between them can be seen that in comparison with accounting the financial reporting contains more significant volume of analytical decoding and explanatory comments that just and ensures its bigger suitability for decision-making of financial character²⁵.

Thus, the financial reporting is understood as uniform system of the indicators reflecting both a financial position and property of the economic subject and results of its

²³Federal'nyi zakon RF N 129-FZ: 21.11.1996 *O buhgalterskom uchete* // Rossiiskaya gazeta. 28.11.1996.

²⁴Federal'nyi zakon RF N 119-FZ: 7.08.2001 *Ob auditor'skoi deyatel'nosti* // Rossiiskaya gazeta. 2001. №151

²⁵Sedova E. I. *Buhgalterskaya (finansovaya) otchetnost' - informacionnaya baza finansovogo analiza* // Konsul'tant buhgaltera. 2006. N 10.

economic activities, constituted on the basis of the data financial and management accounting by results of an accounting period and as of accounting date under the established or independently developed forms.

The financial reporting purpose - satisfaction of information requirements of investors, shareholders, creditors, counterparts, employees, state structures and the public by submission of the information on a financial position, results of economic activities and changes of a financial position of an enterprise for the expired accounting period, useful for a wide range of users from the point of view of decision-making. Also the financial reporting can contain the information on events both last, and future which can essentially affect financial indicators.

The primary goal of the financial reporting is the truthful reflection (imaging) of economic circumstances allowing adequately to evaluate financial circumstances and results of activity of an enterprise.

2.1.3 Financial reporting

It is possible to allocate some features of the financial reporting:

- The financial reporting is formed with the established periodicity, its structure is regulated, and reliability is confirmed with outside audit;
- The financial reporting information has historical character: the accounting is come under only by the come true facts of economic activities though at definition of cost estimates the information of perspective character is often enough used.²⁶

It is possible to make a conclusion on the basis of the above mentioned that the financial accounting department solves the problems of formation property and a financial position of the enterprise, calculation of end results of its activity; its "production" is intended mainly for management of financial both commercial activity and external users of the financial reporting of the enterprise. Accounts of the financial accounting are used for generalization of the information on availability and movement of assets and, inventory, about accounts, taxes and their use, funds and reserves, credits and target financing. Result of the financial accounting is the financial reports which are necessary to understand as a category of the economic information presented by set of indicators of the financial accounting on set

²⁶ Isaev D. *Korporativnaya otchetnost': tendencii i perspektivy* // Finansovaya gazeta. 2008. N 17. p.18

forms, reflected in the form of certain tables and the data representing uniform system about property and a financial position of an enterprise (balance sheet), financial results (profit and lost statement) and changes in a financial position (cash flow statement) of the managing subject for the certain period, constituted on the basis of the data of the accounting (financial) for the purpose of granting to external and internal users of the generalised information on position of an enterprise in the form convenient and clear users for decision-making, in terms established by internal or normative acts.

2.2 Requirements to the quality of financial reporting

2.2.1 Quality

As a starting point one has to ask whether quality is a state, a condition, a feeling, an impression or reality? Linked to this is the question of whether quality has any components and if so what are they? In modern works quality consider from the different points of view.

Quality can refer to

1. A specific characteristic of object
2. The achievement or excellence of an object
3. The essence of an object
4. The meaning of excellence itself

The first meaning is technical, the second practical, the third artistic and the fourth metaphysical. All four meanings, and therefore the meaning of quality, are synonymous with good.

Philosophy and common sense tend to see quality as related either to subjective feelings or to objective facts. The subject-objective in question might be a concrete functional value to be learnt and applied or a physics ideal to be apprehended and represented. A third tends to see quality not as the secondary value that something has, rather a primary truth which comprises apparent and objects.

Quality refers to certain standards and the ways and means by which those standards are achieved, maintained and improved upon. Most definitions given to quality refer to „fitness for use“ or „conformance to requirements“.

The standard definitions on quality have been given by various institutions such as the British Standards Institution (BSI), the American Society for Quality Control (ASQC), the European Organisation for Quality Control (EOQC) and the International Organisation for Standardisation (ISO) amongst others.

„Quality therefore is the totality of features and characteristics of a product or service than bears on its ability satisfy given needs.“ [ANSI/ASQC A3 1978]²⁷

²⁷ Springer London. *Applied Reliability and Quality*. 2007. ISBN 978-1-84628-498-4

Table 1 illustrates a classification of various definitions of quality based on intrinsic and extrinsic factors. These various approaches highlight the wide and varied views on the quality concept. There is however growing support for quality to be closely associated with customer demands, views and perceptions.

Table 1. Various definition of quality

Transcendent definition	Quality is neither mind nor matter, but a third entity independent of the two ... even through quality can't be defined, you know what it is.
Product-based definition	Differences in quality amount to differences in the quality of some desired ingredient or attribute.
User-based definition	Quality consists of the capacity to satisfy wants.
Manufacturing-based definition	Quality means conformance to requirements.
Value-based definition	Quality is the degree of excellence at an acceptable price and the control of variability at an acceptable cost.

The meaning for the term quality has developed over time. Various interpretations are given. However the American Society for quality defines “quality” as “a subjective term from which each person has his or her definition.

2.2.2 Financial reporting quality

What is financial reporting quality? What quality characteristics should have financial reporting? To answer these questions remarks of Chief Accountant of U.S. Securities & Exchange Commission Lynn E. Turner at the European FASB-SEC Financial Reporting Conference (Frankfurt, Germany) are cited. Criteria for high quality financial reporting include: relevance, reliability, representational faithfulness, verifiability, neutrality, comparability and consistency, operationality. Let’s describe each of these criteria²⁸:

Relevance. A high quality accounting standard requires relevant accounting information. The information is relevant if investors can use it when they make investment decisions. The information should permit investors to evaluate past performance and to predict future performance. The information should also enable investors to estimate the risk of an investment.

²⁸ Lynn E. Turner *Speech by SEC Staff: Charting a Course for High Quality Financial Reporting.* The European FASB-SEC Financial Reporting Conference Frankfurt, Germany. March 2000. [www.sec.gov. < http://www.sec.gov/news/speech/spch356.htm>](http://www.sec.gov/news/speech/spch356.htm)

Reliability. High quality financial statements must convey reliable information. Information is reliable to the extent that investors can depend on it to represent the economic conditions or events that it purports to represent. Reliable information has three ingredients: representational faithfulness, verifiability, and neutrality.

Representational Faithfulness. High quality financial statements should reflect the real economics of the transaction being reported. In the U.S., we refer to this concept as representational faithfulness. A map's representational faithfulness may be determined by how well the map describes the coastline. In the same way, a financial statement's representational faithfulness may be evaluated by how well it represents the economic resources and obligations of the company, and by how well the transactions and events that change those resources and obligations are described. For example, suppose that a company reflects future costs in its income statement by setting up reserves in a profitable year and then reducing those reserves in a bad year when the costs are actually incurred. Investors are unable to see the real economic results of the business. Accounting standards that permit this practice lack high quality because they don't exhibit representational faithfulness.

Verifiability. Verifiability means the degree to which different people, when asked to measure something using the same approach, arrive at the same amount. Cash held by a company will possess a high degree of verifiability if several people can count the cash and arrive at the same amount.

Neutrality. Information should be free from bias towards a predetermined result. This quality is referred to as neutrality. For example, in determining income for a period, high quality financial reporting should not bias income to be a high amount or a low amount. Instead, high quality accounting standards should lead to reporting an amount that reports economic activity as faithfully as possible.

Comparability and Consistency. Information about a particular company is more useful if an investor can compare it with similar information about other companies with similar information about the same company for some other time period. The purpose of comparison is to detect and explain both similarities and differences. High quality accounting requires accounting for similar transactions and circumstances similarly and accounting for different transactions and circumstances differently.

In the follow table I would like to show the differences of quality characteristics between IFRS and U.S. GAAP and GAAP in Russia:

Table 2. Different quality characteristics

Qualitative characteristics (GAAP Russia)	Qualitative characteristics (SFAC 2)	Qualitative characteristics (FASB, 1980)
Primary qualities:		
Requirement of fullness	Relevance	Relevance a. Timeliness b. Usefulness
Prudent	Predictive value	
Representational faithfulness	Feedback value	
Timeliness	Timeliness	
Reliability	Reliability a. Verifiability b. Representational faithfulness c. Neutrality	Reliability a. Measurability b. Verifiability (or objectivity) c. Unbiased
Consistency		
Rationality		
Secondary qualities:		
	Comparability	Comparability
	Constancy	Consistency
Constraining qualities:		
		Materiality considerations
		Cost-benefit considerations

There are many well-travelled roads in the quality management profession. Managers have been implementing quality management in typical manufacturing environments for many years, and the principles for doing it are well known. The big challenge in the future will be to take the same principles have learned so well and apply them to areas not so well travelled. There are many fertile areas that are off the beaten path and haven't had much contact with any formalized quality management system. Appears some questions: what place occupies quality requirements of financial reporting in activity of enterprise? How to measure it? How to mange it? How to control it? In the future works the object is set: introduction of parameters of quality of the reporting in a control system of the enterprise and development of a technique of carrying out of monitoring. And it will be based on International Standards of Financial Reporting its principles and concepts.

Thus, the financial reporting is understood as uniform system of the indicators reflecting property both a financial position of the economic subject and results of its economic activities, made on the basis of the data of book keeping by results of the accounting period and as of accounting date under the established forms.

The financial reports purpose - satisfaction of information requirements of investors, shareholders, creditors, counterparts, workers of the various organizations, state structures and the public by submission of the information on a financial position, results of economic activities and changes of a financial position of the enterprise for the expired accounting period, useful for a wide range of users from the point of view of decision-making. Also the financial reports can contain the information on events both last, and future which can essentially affect financial indexations of the reporting industrial enterprise.

The primary goal of the financial reporting is the truthful presentation of an economic situation allowing adequately to evaluate a financial condition and results of activity of the enterprise. It is possible to allocate some features of the financial information:

- the financial accounting is formed with the established periodicity, its structure is regulated, and reliability is confirmed with external audit;
- the financial information has historical character but the come true facts of economic activities are often used as the information of perspective character.

On the basis of the above-stated it is possible to draw a conclusion that the financial accounting department solves the problems of formation property and a financial position of the enterprise, calculation of end results of its activity; its "production" is intended mainly for management of financial both commercial activity and external users of the financial reporting of the enterprise. Accounts of the financial accounting are used for generalization of the information on presence and movement of the basic means, non-material actives, securities and other financial investments, industrial stocks, money resources, calculations, financial results and their use, funds and reserves, credits and target financing. Result of the financial accounting is the financial reporting which is necessary for considering as a category of the economic information presented by set of indicators of the financial accounts under established forms, reflected in the form of certain tables and the data representing uniform system about property and a financial position of the industrial enterprise (accounting balance), financial results (the report on profits and losses) and changes in a financial position (the report on movement of funds) the managing subject for the certain period, made on the basis of the data of the financial account for the purpose of granting to external and internal users of the generalized information on position of the enterprise in the form convenient and clear users for acceptance of administrative decisions, in terms established internal or statutory acts.

The financial information has a number of more features:

- the majority of economic indicators is measured in quantitative expression (cost, a factory load, profit, etc.);
- recurrence, characteristic for the majority of industrial and economic processes allows to reuse the created program;
- dimensions of informational flows (the detailed information on economic processes allows to apply mathematical models to forecasting and management of them);
- has qualitative characteristics (completeness, reliability, timeliness, utility, etc.);
- possibility of the control over reliability of the information (transfer and processing of the economic information is carried out only on legally issued carrier - the document with the signature, the electronic message with a code, etc.).

In this connection the basic directions of researches in the field of the economic information are: adequate display of economic units and processes; development of economic-mathematical methods and models of processing of the economic information; creation of a system of the economic information, satisfying to requirements of management of modern economy. All directions pay significant attention to quality of the information.

Questions connected to quality are considered in such discipline as quality management. In this work pays attention to the problematic of quality evaluation of the financial reporting and internal control system construction. Application of approaches of the quality management (in particular, requests of standards series ISO 900x) for the improvements purpose of characteristics of quality of accounting is expedient. Different aspects of the concepts of quality, allow to apply the given category to any object, called to meet the requirements of consumers. So, in particular, in standard ISO 8402:1994 «Quality management and quality maintenance» is made following definition: Quality – is a set of characteristics of the object concerning its ability to satisfy established and prospective requirements.²⁹

As an object of quality in thesis is the financial reporting - an information product in an information society acts. Thus established and prospective requirements associated with requirements of groups of accounting information users.

In view of quality definition, and also that circumstance that quality is the complex concept characterizing all structural elements of accounting system, it is necessary to designate following basic aspects of the given category in the reporting:

²⁹ Chapkevich L. E. *Kachestvo i bezopasnost' potrebitel'skih tovarov: evolyuciya pravovogo regulirovaniya* // Advokat. 2005. № 7.

1. Quality is a satisfaction of queries and expectations of the accounting system users (practical definition). In this sense it is necessary to designate two target areas of the accounting as practical activity – maintenance of users with the necessary information, and also availability of the mediated effects connected with positive consequences of consumption by users of the received information in the course of the activity;

2. Quality is a set of the characteristics realized in a target accounting information and their significances connected with inquiries and expectations of users (technical definition). To similar characteristics of the financial reporting carry reliability, relevance, timeliness, clearness.³⁰

Thus, it is necessary to understand set of characteristics of the accounting system concerning its ability to satisfy established and prospective information requirements of groups of users of the registration information as quality of the fiscal accounting.

2.2.3 Qualitative characteristics of financial reporting

The analysis of different quality characteristics and the rapprochement of the Russian and Czech accounting system to IFRS has played the advancing decision in a choice of definitions of qualitative characteristics presented to the financial reporting. Most of national accounting principals are based on IFRS. However the Russian legislation and the Russian practice in this part is the only certain treatment IFRS not always corresponding to the first copy. Therefore acquaintance to positions of the international standards requires steadfast consideration and review how do they interpret quality characteristics.³¹

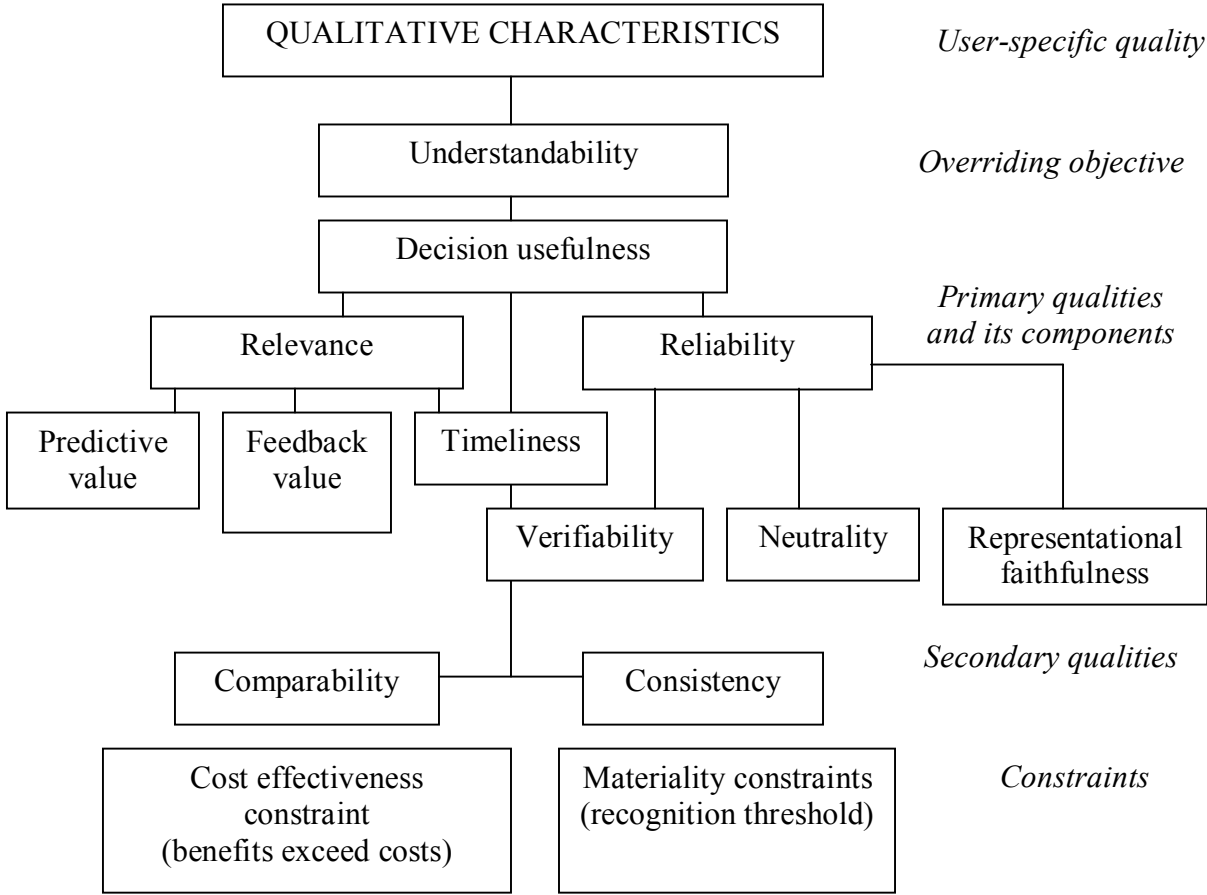
Definitions and treatment to qualitative characteristics are contained by the document entered into the structure of the IFRS carrying the name Framework for the Preparation and Presentation of Financial Statements, (further - "Principles")³². The theoretically based main principles are hanged out. They are divided into two groups: basic assumptions and financial reporting qualitative characteristics.

³⁰ Malyavko A.B. *Aspekty kachestva v mnogolevykh uchetykh sistemah* Volgograd // Vestnik Volgogradskogo gosudarstvennogo universiteta. Vol. 3. 2005. p.194.

³¹ Pyatov M.LSmirnova., I.A. *MSFO: Kachestvennye harakteristiki finansovoi otchetnosti* // BУH.1S. 2007. N 9.

³² Askeri publishing. *Mezhdunarodnye standarty finansovoi otchetnosti (IFRS – 2008)*. 2008. p. 1100

As basic assumptions, that is theoretically designed constructions, which give the base to accounting methodology presented the following principals: the accrual basis and an assumption of a continuity of activity. To reporting qualitative characteristics, that is, according to the text of standards to "the attributes doing the information represented in the financial reporting useful to users", are carried consistency, relevance, reliability and comparability. The classification of characteristics is presented in the picture 4.



Picture 4. Hierarchy of desirable characteristics of accounting information

It is necessary to pay attention that the role of the accounting information containing in the external financial reporting of an enterprises has little distinction from the Russian and Czech. According to IFRS the accounting information has to be useful to users for decision-making on the basis of the financial reporting analysis. Thus, «according to composers of IFRS, observance of requests and the rules to the qualitative characteristics, does financial

reports comprehensible basis for acceptance of administrative decisions concerning the enterprise which reporting is analyzed»³³.

Further it is necessary to consider each qualitative characteristic and to show its essence and the way of understanding in the given thesis

To satisfy the stated objectives, information should possess certain characteristics. The purpose of standards is to outline the desired qualitative characteristics of accounting information.

Picture 4 indicates these qualitative characteristics, presented in the form of a hierarchy of their perceived importance. Notice that the main focus, as stated in the first concept statement is on decision usefulness - the ability to be useful in decision making. Understandability means that users must understand the information within the context of the decision being made. This is a user-specific quality because users will differ in their ability to comprehend any set of information. The first stated financial reporting objective is to provide comprehensible information to those who have a reasonable understanding of business and economic activities and are willing to study the information.

To be useful, information must make a difference in the decision process.

Primary qualitative characteristics

The primary decision-specific qualities that make accounting information useful are relevance and reliability. Both are critical. No matter how reliable, if information is not relevant to the decision at hand, it is useless. Conversely, relevant information is of little value if it cannot be relied on. Let's look closer at each of these two characteristics, including the components that make those qualities desirable. We also consider two secondary qualities—comparability and consistency. To be useful for decision making, accounting information should be relevant and reliable.³⁴

Relevance. To make a difference in the decision process, information must possess predictive value and/or feedback value. Generally, useful information will possess both qualities. For example, if net income and its components confirm investor expectations about future cash-generating ability, then net income has feedback value for investors. This confirmation can also be useful in predicting future cash-generating ability as expectations are revised.

³³ Pyatov M.L.Smirnova., I.A. *MSFO: Kachestvennye harakteristiki finansovoi otchetnosti* // BУH.1S. 2007. N 9.

³⁴ Departament metodologii, standartizacii i upravleniya kachestvom auditorsko-konsaltingovoi firmy "CBA". *Otchetnost' po MSFO: sostav, struktura, trebovaniya k raskrytiyu informacii* // Novaya buhgalteriya. 2007. vol. 2

This predictive ability is central to the concept of “earnings quality,” the ability of reported earnings (income) to predict a company’s future earnings. This is a concept we revisit frequently throughout this textbook in order to explore the impact on earnings quality of various topics under discussion. For instance discussing the contents of the income statement and certain classifications used in the statement from the perspective of helping analysts separate a company’s transitory earnings from its permanent earnings. This separation is critical to a meaningful prediction of future earnings.

Timeliness also is an important component of relevance. Information is timely when it is available to users early enough to allow its use in the decision process. The need for timely information requires that companies provide information to external users on a periodic basis. Some normative acts requires its registrants to submit financial statement information not only on an annual basis, but also quarterly for the first three quarters of each fiscal year. Information is timely if it is available to users before a decision is made.³⁵

Reliability. Reliability is the extent to which information is verifiable, representationally faithful, and neutral. Verifiability implies a consensus among different measurers. For example, the historical cost of a piece of land to be reported in the balance sheet of a company is usually highly verifiable. The cost can be traced to an exchange transaction, the purchase of the land. However, the market value of that land is much more difficult to verify. Appraisers could differ in their assessment of market value. The term objectivity often is linked to verifiability. The historical cost of the land is objective but the land’s market value is subjective, influenced by the measurer’s past experience and prejudices. A measurement that is subjective is difficult to verify, which makes it more difficult for users to rely on.³⁶

Representational faithfulness exists when there is agreement between a measure or description and the phenomenon it purports to represent. For example, assume that the term inventory in a balance sheet of a retail company is understood by external users to represent items that are intended for sale in the ordinary course of business. If inventory includes, say, machines used to produce inventory, then it lacks representational faithfulness. Representational faithfulness means agreement between a measure and a real-world phenomenon that the measure is supposed to represent.

³⁵ Suvorov A.V. *Osobennosti principov ucheta i osnovnye harakteristiki finansovoi otchetnosti, sostavlennoi po MSFO // Mezhdunarodnyi buhgalterskii uchet.* 2006. N 10.

³⁶ Pyatov M.L., Smirnova I.A. *Princip konservatizma. // BUIH.IS. 2007. № 3. p. 40*

Several years ago in US GAAP, accountants used the term reserve for doubtful accounts to describe anticipated bad debts related to accounts receivable. For many, the term reserve means that a sum of money has been set aside for future bad debts. Because this was not the case, this term lacked representational faithfulness. The description “reserve...” now has been changed to “allowance for uncollectible accounts” or “allowance for doubtful accounts.” In FedEx Corporation’s financial statements, the balance sheet in Appendix B reports Receivables, less allowances of \$151 million and \$149 million at the end of 2004 and 2003, respectively.³⁷

Reliability assumes the information being relied on is neutral with respect to parties potentially affected. In that regard, neutrality is highly related to the establishment of accounting standards. You learned earlier that changes in accounting standards can lead to adverse economic consequences to certain companies, their investors and creditors, and other interest groups. Accounting standards should be established with overall societal goals and specific objectives in mind and should try not to favor particular groups or companies. Accounting standards should not favor any particular groups or companies nor influence behavior in any specific way.³⁸

The standards face a difficult task in balancing neutrality and the consideration of economic consequences. A new accounting standard may favor one group of companies over others, but the FASB must convince the financial community that this was a consequence of the standard and not an objective used to set the standard. Donald Kirk, one of the members of the first group to serve on the FASB, stressed the importance of neutrality in the standard-setting process.

The qualities of relevance and reliability often clash. For example, a net income forecast provided by the management of a company may possess a high degree of relevance to investors and creditors trying to predict future cash flows. However, a forecast necessarily contains subjectivity in the estimation of future events. GAAP presently do not require companies to provide forecasts of any financial variables. A trade-off often is required between various degrees of relevance and reliability.³⁹

If financial reporting is to be credible, there must be public confidence that the standard-setting system is credible, that selection of board members is based on merit and not

³⁷ FedEx.com. *Investors relations. Annual reports. 2008.* < <http://ir.fedex.com/annuals.cfm> >

³⁸ Voropaev Y.N. *Sistema vnutrennego kontrolya organizacii.* // Buhgalterskii uchet. 2003. N 9.

³⁹ Get'man V.G. *O konceptual'noi osnove mezhdunarodnyh standartovfinansovoi otchetnosti* // Mezhdunarodnyi buhgalterskii uchet 2007. N 12

the influence of special interests, and that standards are developed neutrally with the objective of relevant and reliable information, not purposeful manipulation.

Secondary qualitative characteristics

Picture 4 identifies two secondary qualitative characteristics important to decision usefulness—comparability and consistency. Comparability is the ability to help users see similarities and differences between events and conditions. We already have discussed the importance of the ability of investors and creditors to compare information across companies to make their resource allocation decisions. Closely related to comparability is the notion that consistency of accounting practices over time permits valid comparisons between different periods. The predictive and feedback value of information is enhanced if users can compare the performance of a company over time. In the FedEx financial statements in Appendix B, notice that disclosure Note 1 includes a summary of significant accounting policies. A change in one of these policies would require disclosure in the financial statements and notes to restore comparability between periods. Accounting information should be comparable across different companies and over different time periods.

Data of the modern financial accounting can tell very much about enterprise, but not everything. There are certain borders of information possibilities of the financial reporting. Their understanding is a necessary condition of the objective analysis of the accounting information (financial reporting).

Principles defines that financial reporting qualitative characteristics have certain restrictions in application which should be considered fully at its preparing.

First of all, restriction in interaction of such characteristics as relevance and reliability: delay in presentation of accounts in most cases leads to increase of its reliability, but simultaneously attracts relevance loss.

Secondly, the balance between benefit and expenses assumes that the benefits extracted from the information, should not exceed an expense for its preparation. The reverse situation in overwhelming majority of cases leads to loss of relevance of the information.

Thirdly, for a compromise establishment between reporting qualitative characteristics in most cases it is necessary to have the professional judgement how to carry out a problem of formation of the financial reporting at preservation of all qualitative characteristics and

balance observance between them⁴⁰. The matter is that each of considered above accounting information qualitative characteristics actually represents the independent theoretical construction which forms certain approaches to accounting interpretation of the facts of an economic activity. Here again it is necessary to underline independence of theoretical positions in frameworks of each of them. However the theoretical positions underlying characteristics, can conflict with each other. Each principle as the independent theoretical design has certain borders, and its consecutive application in practice often happens impossible.⁴¹ It is considered that accounting information qualitative characteristics should counterbalance each other. The persons responsible for granting of this information are obliged to care about such a balance. The parity between qualitative characteristics is a subject of professional valuation of the accountant and is subject to a problem of satisfaction of requirements of users of the financial reporting. In the issue the problem of the accountant consists in reaching a corresponding parity between qualitative characteristics of an accounting information for achievement of a main purpose of the financial reporting.⁴²

At the same time all qualitative characteristics of financial reports should be observed with taking into account "expense-benefit" restrictions, that is benefit from the received information should be more expenses for its reception.⁴³

Thus, it is possible to draw a conclusion that in accounting practice quite often happens that it is necessary to find an optimum combination of all qualitative characteristics proceeding from requirements of users of the accounting information and priorities of the development of the enterprise, therefore such characteristics are exposed to professional valuation and judgment of experts with attraction of auditing firms.

The understanding of the considered characteristics of the accounting information has great value for an estimation of the contents of the financial reporting. Knowledge of the restrictions inherent in the accounting information, that is borders of informativeness of the financial reporting, helps objectively perceive the economic information presented in the reporting. In this case only expectations of the user concerning the contents of the information will not surpass their real possibilities in demonstration of a state of the position of the

⁴⁰ Konik N.V., Fil'chakova S.O. *Struktura MSFO. Standarty. Interpretacii*// Novaya buhgalteriya. 2006. vol. 11. Godovoi otchet 2006 dlya kreditnyh organizacii.

⁴¹ Pyatov M.L., Smirnova I.A. *Ogranicheniya umestnosti i nadezhnosti buhgalterskoi informacii v traktovke MSFO.* // BUH. IS. 2008. N 3

⁴² Suvorov A.V. *Osobennosti principov ucheta i osnovnye harakteristiki finansovoi otchetnosti, sostavlennoi po MSFO*// Mezhdunarodnyi buhgalterskii uchet. 2006. N 10.

⁴³ Peteneva E.N. *Sravnitel'nyi analiz osnovnykh principov podgotovki finansovoi otchetnosti po MSFO i rossiiskimi PBU*// Vnedrenie MSFO v kreditnoi organizacii. 2006. N 5.

reporting company. Hence, quality of the financial reporting is necessary to understand as set of the characteristics realised in the accounting information and their significances concerning its ability to satisfy established and prospective information requirements of the accounting information user, and also balance between them with taking into attention the restrictions connected with demands and expectations of users.

2.3 Essence of quality assurance of the financial reporting

Nowadays wide experience is accumulated in such area as a quality management. Managers of enterprises introduced a quality management into production, and many problems and principles today are well studied. It is necessary to draw a conclusion that the accumulated knowledge is required for application of old principles in new areas.

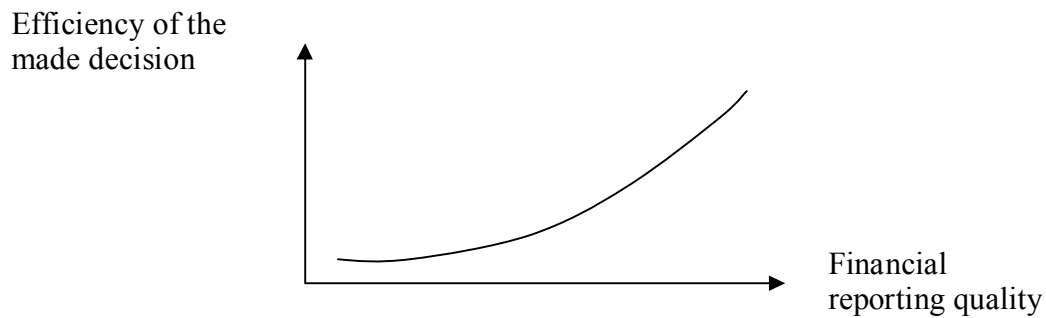
In 2004-2005 company PriceWaterhouseCoopers has interviewed investors and analysts of 14 countries concerning of the financial reporting quality of enterprises. Results have shown that only 19 percent of the interrogated investors and 27 percent of analysts recognised financial reports as the useful instrument of revealing of original cost of the enterprise. Meanwhile in the USA only 38 percent of chiefs consider the reporting of the enterprises useful decision-making.⁴⁴

There are exists five levels of awareness of the managing subject according to I.Ansoff.⁴⁵ The high level associates with volume and quality of the information, sufficient for definition of all possible consequences of the spontaneous phenomena and acceptance of measures for the further positive development of the subject. The lowest level of awareness is characterised by the least volume of the helpful information for adequate reaction to changes. In other words, there is a probability of occurrence of any adverse event, however its nature and/or a source up to the end didn't define.

From the aforesaid it is possible to draw a conclusion that efficiency of the administrative decision depends on quality of the financial reporting. Graphically dependence of efficiency of the decision on the reporting quality is presented in picture 5.

⁴⁴ Burcev V. *Budushee finansovoi otchetnosti* // Konsul'tant. 2006. N 15.

⁴⁵ Ansoff I. *Strategicheskoe upravlenie*. Ekonomika. 1989. p.89



Picture. 5 Reporting quality influence on decisions

Many consulting and auditing firms carry out the analysis and an estimation of factors influencing qualities of the financial reporting. To the given (external) factors refer:

- the legislation;
- an educational level;
- capital market development;
- integration of economy;
- a level of development of auditors institute etc.

Also it is possible to allocate internal factors:

- a system effectiveness of the internal control (further - IC);
- a policy of management on availability of the information;
- experience and qualification of accounting staff;
- the chosen methods and politicians of the account and the reporting;
- the enterprise purposes;
- the contractual policy etc.;
- completeness of registration of financial and economic operations, etc.

Based on the work of Hongjiang Xu “Critical Success Factors for Accounting Information Systems Data Quality”⁴⁶, we should mention the following influencing quality reporting factors:

- top management commitment to DQ;
- education and training;
- clear DQ vision for the entire organization;
- DQ policies and standards;
- DQ controls;
- customer focus;
- nature of the AIS;
- employee relations;
- change management;

⁴⁶ Hongjiang Xu. *Critical Success Factors for Accounting Information Systems Data Quality*. Ph.D. thesis. University of southern queensland. 2003. p. 259

- data quality supplier quality management;
- continuous improvement;
- audit and reviews;
- internal controls etc.

Studying the literature and understanding the qualitative characteristics it is possible to make a conclusion that at formation of the control of quality of the financial reporting is necessary to consider the following factors: a neutrality of accounting principles and contractual relations; knowledge of users, experience and qualification of workers; availability of the information; quality of audit both internal, and external; changes in an accounting policy and accounting methodology; mistakes risks, partial registration risk, accounting information reflexions; the relation of a management to quality assurance of the financial reporting and level of a personal liability of the persons who are responsible for reports preparation, movement and processing of the registration data, etc.

2.3.1 Topicality and urgency. Financial reporting quality importance

The question of the financial reporting control on conformity to qualitative characteristics as economic information for decision-making is poorly studied in a theoretical and practical field of knowledge. There are no standard quality evaluation methods of the reporting which would consider all variety of the factors influencing the reporting. For example, there are requests regulating, what qualitative characteristics the reporting should have, the documents regulating an internal control system, but there are no indicating how to conduct quality evaluation.

Quality of the financial reporting is in the centre of attention of investment community since 2001. The brief historical information is necessary for understanding of an acuteness of this problem.

Enron, established in Houston in 1985, by 2001 became the seventh company in the USA on volume of proceeds, being engaged in purchase of an electricity at the generating companies and sale to its consumers. In 2001 heads of Enron have recognized, that since 1997 the company has unreasonably overestimated the profit on 580 million dollars. The commission under securities and stock exchanges of the USA has begun investigation of activity of partnership, and the main competitor of the company has refused the transaction on amalgamation with Enron for the sum of 8.4 billion dollars. On December, 2nd, 2001 Enron

has submitted the application for bankruptcy which for that moment was the largest corporate bankruptcy in history of the USA. Its share cost one year prior to it of more than 80 dollars, have fallen up to the price less than 1 dollar for the action. Enron collapse has deprived investors of their capital and has left thousand employees without work and pension accumulation.

Authorities of the USA have operatively reacted to the opened weakness of the control system of quality of the financial reporting by acceptance on January, 23rd, 2002 Sarbanes-Oxley Act of 2002. The law is directed on protection of investors through improvement of accuracy and reliability of disclosing of the corporate information made according to the legislation on securities. In many respects because of rigid positions of this law, many emitters now make a choice in favour of the European stock exchanges for stock floatation. In July, 2002 to the USA the application for bankruptcy has submitted WorldCom, one of the largest telecommunication companies. According to, made in the end of 2003, a upward distortion of assets in financial reporting WorldCom made about 12 billion dollars. In December 2003 bankruptcy of Italian Parmalat has begun after it became known about registration in assets of the company of the nonexistent bank account for the sum of 3.9 billion dollars.

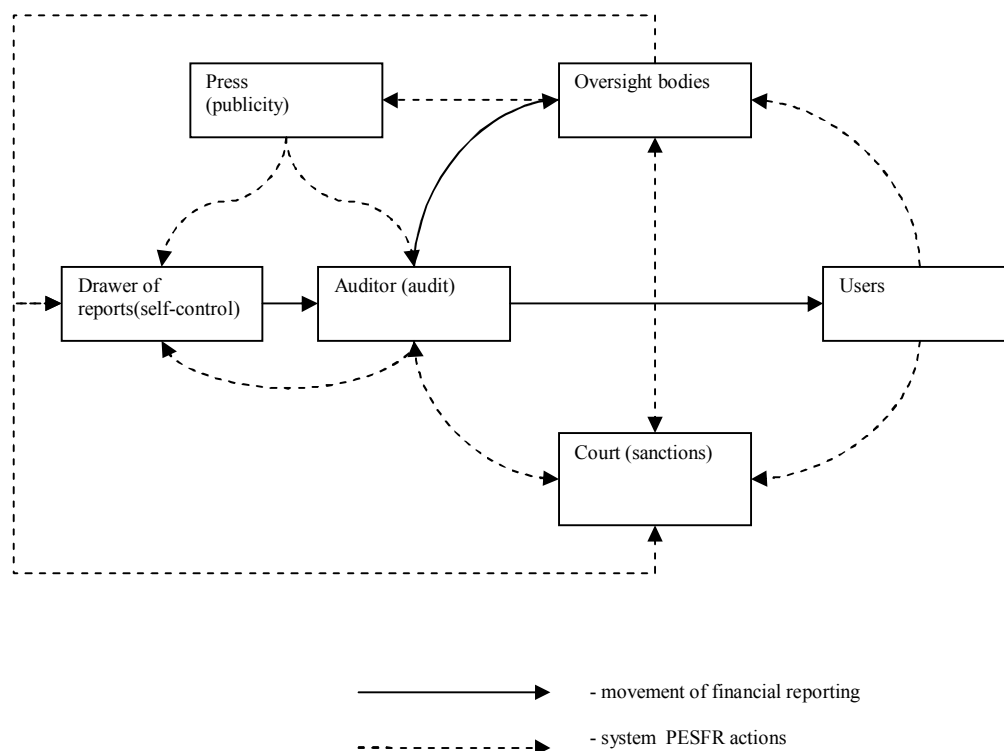
These bankruptcies have once again confirmed extreme importance of a problem of the quality control of the financial reporting. The case with Parmalat also has shown, that similar financial crises can happen not only in the USA, but also in the Europe. The European control system now is in process of reforming.

In the Europe bankruptcy of Enron and acceptance of Sarbanes-Oxley Act has urged begun earlier discussion. It was in connection with creation of the uniform financial market and transition on IFRS and about the monitoring system of quality of the financial reporting. Delay with acceptance of concrete actions has been partly connected with the limited influence of transatlantic bankruptcy on the Europe and with proved criticism to address of Sarbanes-Oxley Act which in opinion of many was excessive reaction to market events. Even before these events, the European federation of accountants has carried out researches of mechanisms of the control of quality of the financial reporting in the various countries of the Europe (report *Enforcement Mechanisms in Europe*, April 2001)⁴⁷. The same organization

⁴⁷ Report *Enforcement Mechanisms in Europe*. April 2001. FEE Study. < <http://www.iasplus.com/restruct/euro2001.htm> >

has given the recommendation on maintenance of performance IFRS in April, 2002 (Discussion Paper on Enforcement of IFRS within Europe⁴⁸).

Pic.1 System PESFR



Picture. 6 Reporting quality influence on decisions

The objective and authentic financial reporting is necessary for effective functioning the financial markets. To provide such reporting, are necessary both standards of the financial reporting, and system of providing the execution of the financial reporting standards (further - "system PESFR", scheme on the picture 6). Without such system no standards of the financial reporting will be executed.⁴⁹

Critical importance of the monitoring and control system was brightly showed on an example of recent bankruptcies Enron, Worldcom, Parmalat. Mistrust to the financial reporting brakes development of the investments market. Not only foreign, but also internal investors not always dare to become shareholders of the companies. Poor quality of the financial reporting creates a barrier to hit of money of the population on a securities market,

⁴⁸ FEE Discussion Paper on Enforcement of IFRS in Europe. April 2002. FEE. < <http://www.iasplus.com/restruct/euro2002.htm> >

⁴⁹ *Koncepcija sistemy obespecheniya ispolneniya standartov finansovoi ochetnosti // Vnedrenie MSFO v kreditnoi organizacii. 2006. №№ 3, 4, 5.*

that on the one hand brakes investment processes in the country, and with another - increases a property inequality, doing reception of the income of savings the exclusive privilege rich which dispose of large share holdings and often have access to additional information which have been not reflected in the public financial reporting.

Transition to qualitative international standards of the financial reporting will raise the financial information quality only in case of creation of system of maintenance of execution of standards of the financial reporting. This system consists from:

- Self-checking (control) of the companies - composers of the reporting,
- Independent audit,
- Supervising bodies,
- publicity of decisions of supervising bodies and
- sanctions for infringements.

This research pays attention to the only one element - self-control.

2.3.2 Financial reporting quality through the internal control

Internal and external pressures motivate the accounting and management professions to continue to develop and refine internal control concepts. As a result of this work where created the following documents⁵⁰:

*COBIT: Control Objectives for Information and related Technology*⁵¹

Definition: COBIT - (the Information Systems Audit and Control Foundation's Control Objectives for Information and related Technology) adapted its definition of control from COSO: The policies, procedures, practices, and organizational structures are designed to provide reasonable assurance that business objectives will be achieved and that undesired events will be prevented or detected and corrected. COBIT adapts its definition of an IT control objective from SAC: A statement of the desired result or purpose to be achieved by implementing control procedures in a particular IT activity. COBIT emphasizes the role and impact of IT control as they relate to business processes. The document outlines platform and application independent IT control objectives. The COBIT framework provides high-level

⁵⁰ Janet L. Colbert, Paul L. Bowen. *Comparison of Internal Controls: COBIT, SAC, COSO and SAS 55/78*. // IS Audit and Control Journal. 1996. № IV. p. 26-35

⁵¹ COBIT. *ISACA (The Information Systems Audit and Control Foundation's Control Objectives for Information and related Technology*. <<http://www.isaca.org/Template.cfm?Section=COBIT6&Template=/TaggedPage/TaggedPageDisplay.cfm&TPLID=55&ContentID=7981>>

control statements for particular IT processes. The framework identifies the business need satisfied by the control statement, identifies the IT resources managed by the processes, states the enabling controls and lists the major applicable control objectives.

SAC Report

The SAC (SAS 55, 78) - (the American Institute of Certified Public Accountants' Consideration of the Internal Control Structure in a Financial Statement Audit) report defines the system of internal control, describes its components, provides several classifications of controls, describes control objectives and risks, and defines the internal auditor's role. The report provides guidance on using, managing, and protecting information technology resources and discusses the effects of end-user computing, telecommunications, and emerging technologies. Definition: The SAC report defines a system of internal control as: a set of processes, functions, activities, subsystems, and people who are grouped together or consciously segregated to ensure the effective achievement of objectives and goals. The report emphasizes the role and impact of computerized information systems on the system of internal controls. It stresses the need to assess risks, to weigh costs and benefits, and to build controls into systems rather than add them after implementation.

*COSO Report*⁵²

The COSO - (the Committee of Sponsoring Organizations of the Treadway Commission's Internal control - Integrated Framework) report defines internal control, describes its components, and provides criteria against which control systems can be evaluated. The report offers guidance for public reporting on internal control and provides materials that management, auditors, and others can use to evaluate an internal control system. Two major goals of the report are to (1) establish a common definition of internal control that serves many different parties, and (2) provide a standard against which organizations can assess their control systems and determine how to improve them. Definition: The COSO report defines internal control as: a process, effected by an entity's board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- effectiveness and efficiency of operations
- reliability of financial reporting
- compliance with applicable laws and regulations.

⁵² The Committee of Sponsoring Organizations of the Treadway Commission's. *Internal control - Integrated Framework* <www.coso.org>

The report emphasizes that the internal control system is a tool of, but not a substitute for, management and that controls should be built into, rather than built onto, operating activities. Although the report defines internal control as a process, it recommends evaluating the effectiveness of internal control as of a point in time.

The listed documents include the general concepts of the internal control, thus later documents are constructed on the principles developed in earlier. If to speak about practice of use of the given documents in most cases they contain only main principles of the internal control, so that requires clarifications for each enterprise and attraction of experts with an operational experience in this area. However, it is necessary to notice that at the heart of system of the internal control the control system of operational risks is put. It methodologically simplifies work on its creation and perfection. On the basis of requests to the internal control system it is possible to advance main principles of its construction: the organisation of the internal/administrative environment in the company; an establishment of the purposes of development of the company; definition of methods of identification of risks and methods of their estimation; a choice of management methods risks (a risk aversion, reduction, redistribution or acceptance); an establishment of main principles of the control procedures organisation; determination of communication media and information interchange, and also means of testing of an internal control system.

2.3.3 Present day research field

In order to show the present day research field condition it is necessary to study the modern articles published by scientific and professional societies such as:

1. *Accounting Information Quality: An Area of Extended Thinking*.⁵³ According to the article Information Quality is an emerging area of research that crosses many disciplines. Providing and assuring quality information has been the primary objective of accounting since the inception of the field. With the advent of Accounting Information Systems (AIS), the traditional focus on the input and recording of data needs to be offset with a recognition that the systems themselves may affect the quality of information. That is why it should be monitored. In article authors examined (1) the overlapping dimensions, (2) exclusive

⁵³ Mohammad Badrul Haider, Taslima Akhter *Accounting Information Quality: An Area of Extended Thinking*. // The Cost and Management, Vol. 34 No. 3, May-June 2006, pp. 5-14, ISSN1817-5090

dimensions, and (3) common dimensions of Accounting Information System and Management Information Systems frameworks. Reconciling the two approaches in defining IQ offers lessons to be learned for both the accounting and IQ areas.

2. *Internal Control —Integrated Framework. Guidance on Monitoring Internal Control Systems*⁵⁴. The COSO board believes that the monitoring component of a properly designed and functioning internal control system — utilizing COSO’s Internal Control – Integrated Framework — has often been underutilized by organizations of all sizes. This discussion document, which is the first phase of our broader monitoring project, is intended to improve the understanding of the building blocks of effective monitoring, thereby improving both the efficiency and the effectiveness of the entire system of internal control. The guidance presented is effective for all three internal control objectives, including the financial reporting objective that is relevant to public reporting under the Sarbanes-Oxley Act of 2002 or under similar regulatory initiatives around the world.

3. *Does Information Risk Really Matter? An Analysis of the Determinants and Economic Consequences of Financial Reporting Quality*⁵⁵. Author suggests that the quality of accounting information cannot be characterized as an additional systematic priced risk factor, but rather as an idiosyncratic one, once the firm specific characteristics determining information quality are controlled for. These results demonstrate the importance of explicitly controlling for the determinants of financial reporting quality when investigating the associated economic consequences and question recent empirical evidence on the association between reporting quality and the cost of equity capital.

4. *Seasoned Equity Offerings: Quality of Accounting Information and Expected Flotation Costs*⁵⁶. Using a large sample of seasoned equity offerings, they show that poor accounting information quality is associated with higher flotation costs in terms of (1) larger underwriting fees, (2) larger negative SEO announcement effects, and (3) a higher probability of SEO withdrawals.

⁵⁴ Committee of Sponsoring Organizations of the Treadway Commission *Internal Control —Integrated Framework. Guidance on Monitoring Internal Control Systems*. Discussion Document. September 2007. <www.coso.org>

⁵⁵ Cohen, Daniel A. *Does Information Risk Really Matter? An Analysis of the Determinants and Economic Consequences of Financial Reporting Quality*. January 23, 2006. <<http://ssrn.com/abstract=896102>>.

⁵⁶ Lee, Gemma and Masulis, Ronald W. *Seasoned Equity Offerings: Quality of Accounting Information and Expected Flotation Costs*. February 21, 2008. <<http://ssrn.com/abstract=917044>>

5. *Прозрачная отчетность. Как построить эффективную систему внутреннего контроля*⁵⁷ (Transparent reporting: How to build internal control system). It is the article wrote by the professional IT-departments consultants and can be apprehended like a guidance on internal control system on financial reporting quality monitoring. It also consider with IT controls and IT risks, which should be taken into mention of the top management and monitoring system builders.

Heads of the companies are obliged to estimate documentary system of the internal control, having reflected in the report all its essential lacks and prospective measures on their elimination. The estimation approved by general and financial directors, should pass check at the external auditors, obliged to generate the separate conclusion which will be published together with the annual financial reporting of the company. The basic requirements of the SOX law are that. Now in many countries work over creation of similar laws that shows an urgency of problems on construction of system of the internal control. However it is important to notice also that the given system created under requirements of law Sarbanes-Oxley, which is only one of elements of the general control system of conformity. Such system allows to identify the basic requirements to activity of the company and to provide conformity with it. Legislative statutory acts can concern similar requirements (such, as law Sarbanes-Oxley), requirements on quality of products/services and processes of their creation, branch standards, the private requirements exposed by shareholders and company management. Hence, the problem of system construction of the internal control is important not only from the point of view of presence at the American or any other stock exchange, but also from an item of minimization of risks and decrease in degree of discrepancy to various standards.

2.3.4 Success factors for Internal control from practice

Summarizing the analysis of the operational experience of the different companies⁵⁸ it is necessary to show some of the success factor and lessons from positive practice.

⁵⁷ Berkovich V., Koptelov A.K.. *Прозрачная отчетность. Как построить эффективную систему внутреннего контроля (Transparent reporting: How to build internal control system)* // Risk management № 5-6 may-june. 2007.

⁵⁸ International Federation of Accountants. Professional Accountants in Business Committee. *Internal Control from a Risk-Based Perspective*. August, 2007. ISBN 1-931949-84-0

John Boers is Chief Financial Officer for Nationale-Nederlanden, the largest Dutch insurance company, a subsidiary of ING Group. He is responsible for finance and risk management.

- *Introduce a continuous enterprise risk management process in your organization. Make it part of your management decision-taking and your product development process. Embed sufficient controls in the operational processes. And finally, think through internal controls as well.*
- *Keep risk management as close to the business as you can. Don't let it become too high level a process. Make it local so that everyone is aware of what is going on.*
- *The whole spectrum of risk should be covered. Don't build silos, or run it on a standalone basis. The important qualities are cooperation and mutual understanding.*

John Fraser is Vice-President, Internal Audit and Chief Risk Officer at Hydro One Inc., the largest electricity delivery company in Ontario, Canada. The Chief Risk Officer has a methodology and facilitation role. All risk management and accountability remains with line management.

- *Have good people who know what they are doing.*
- *Internal control is just one way of getting enterprise risk management to work. The key is good governance.*
- *You have to explain the risks you are addressing.*

William Henry Harmon is President and CEO of Triana Energy, an affiliated group of private companies in the oil and gas industry on the eastern seaboard of the United States.

- *An effective business enterprise is one integrated system. Get everyone involved, get organized, and do it. The piecemeal approach doesn't work effectively.*
- *First see if there are common-sense controls that fit within the natural flow of the business.*
- *Most of the time, effective controls are not expensive. In fact, they frequently pay for themselves in terms of lost time avoidance.*
- *Without proper documentation, management has no grounds for assurance of system integrity, the audit-ability of the system is compromised, and subsequent modifications of the system become more complicated.*

Oscar Lewis is Controller with Umbra Cuscinetti Inc., an aerospace company that manufactures precision ball screws and other components, based in Washington State.

- *Document what you do. Unless you know how things work, you can't improve them.*
- *Make sure everyone who is affected is involved in the risk management process.*
- *It is better to do it slower and well than quickly and have to do it over and over again.*

Rob Whiteman is Chief Executive, London Borough of Barking and Dagenham, a large suburban and industrial area lying just to the east of London, England.

- *Risk management and internal control are part and parcel of effective use of resources and performance. Therefore, you need to consider risk, performance information, financial information and quality when designing services to achieve value.*

- *Have the right balance in terms of risk assessment and effective internal control in relation to your partnerships to safeguard your interests and resources without stifling each partnership with unnecessary bureaucracy.*
- *An integrated approach to internal audit should ensure that you remain outcome focused so that internal control and risk management produce real performance gains.*

Thus, novelty of research consists in allocation of such segment as a financial reporting estimation on a meeting the requirements to qualitative characteristics. The given kind of the control is an independent direction in system of the internal control, and allows to increase a transparency and quality of the financial reporting.

2.4 Financial reporting quality control

Financial condition - the major characteristic of economic activities of the enterprise. It defines competitiveness of the enterprise and its potential in business cooperation, serves as the guarantor of effective realization of economic interests of all participants of financial attitudes: both the enterprise, and its partners.

The steady financial position grows out the skilful management of all set of the production and economic factors which define results of activity of the enterprise. The financial reporting of the enterprise is a basis of an estimation of a financial condition.

Studying of literary source of the accounting, financial accounting and the analysis of the financial reporting, of drawing up of the financial reporting has shown practical absence in it the considerations of such question, as an estimation of quality of the financial reporting. Therefore appears a question: what place does the financial reporting quality control occupy in activity of the enterprise? At the same time there is no uniform approach of economists on exact definition of the maintenance and a place of the monitoring system and supervision over quality of the reporting. The same way as definition the position of given kind of supervision isn't determine. Whether this system is an independent section or a component of financial monitoring or monitoring of a financial condition or Internal Control of the company.

The effective system of the internal control is the first barrier on a way of distortion of the reports. Purposeful formation by the organizations of procedures of the internal control will positively affect quality of the reports. At the same time, detailed legislative requirements to system of the internal control are hardly expedient, as it is complex to consider distinctions at a rate of and structure of the different organizations, and about necessity of realization of

the internal control, it is complex to provide execution of declarative legislative norm in practice.

First of all the internal control is necessary for the companies with the public accountability as importance of their reporting for users justifies additional charges on maintenance of its quality. Besides, the financial reporting should correspond to the legislation and standards of accounting (consider influence of accounting standards changes and requirements about disclosing the information, stipulated by the legislation or rules of Stock exchange). The review of the financial reporting and results of internal audit together with a management and external auditors is important. The given review usually covers such questions, as: correctness of disclosing of the information in the financial reporting; character and influence of changes in principles of book keeping within a year; the principles of book keeping used concerning large operations; the reasons of unusual deviations of values of financial parameters or discrepancies to branch tendencies.

One of conditions of success is the financial transparency of business which is closely connected with quality of the organization of the financial accounting in the company, with quality of the financial reporting. The transparency of the financial reporting is provided due to full opening and authentic representation of the helpful information necessary for the broad audience of users for economic decision-making.

Procedure of improvement of quality of the financial reporting assumes:

- Using the accounting process with the qualitative characteristics of the financial reporting providing authentic and objective representation of the information on which are based IFRS;
- Standardization and unification of the accounting;
- the control and monitoring of quality of the reporting.

Improvement of quality of the reporting will allow:

- to receive correct show of condition of the company;
- to confirm reliability of the company for strategic investors and partners;
- to provide a financial transparency of business.

For the financial reporting quality within internal control system is necessary to answer the question if your organization is able to:

- provide correct information to the people who need it, when they need it;

- provide timely, forward-looking metrics in evaluating overall business performance;
- enable effective decision-making.

The purpose of the reporting quality control can be gathering, studying and preparation of the information for decision-making and the analysis of administrative decisions. It causes two features with which should satisfy control as system of gathering and processing of the information: a target orientation of information processes and the maximal objectivity of received conclusions at each stage of data processing.

Though at the enterprises the estimation of a financial condition is annually, it is necessary to develop, constantly to improve and estimate system of the internal control, necessary to develop a technique of an estimation of quality of the reporting of the enterprise specially for the certain enterprise in view of all features, to take advantage of statistical data and to draw corresponding conclusions, to make constant control.

Thus, reporting quality control can be named the mechanism of the constant supervision over the major current processes of financial and economic activity, and an estimation of their influence on quality of the financial reporting in conditions of constantly varying external and internal environment. The purposes of the control mechanism development are constant detection of deviations of data in the reporting from actual results of activity, definition of clauses causing distortion of a real financial condition of the enterprise, revealing of size of influence of the given distortions and qualities of the reporting as a whole on decision-making, and also revealing of the reasons causing these deviations and distortions, and development of offers on corresponding correction for improvement of the reporting quality.

For achievement of the control object were solved following tasks:

- continuous supervision of the reporting correctness and reception of the operative information;
- association of the information streams formed by various departments of the organization, participating in monitoring;
- duly revealing of the changes occurring inside of the enterprise, and the factors which have caused them, estimation of influence of these changes on quality of the financial reporting;
- duly revealing of changes in the legislation in the field of the accounting;
- an estimation and a choice of the most comprehensible variants of the reporting, definition of accounting policy;

- realization of short-term forecasting development of the major processes at the enterprise, an estimation of an opportunity of influence of the given processes on the reporting of the enterprise;
- an estimation of a situation for duly decision-making on planning and realization of effective actions;
- preparation of the recommendations directed for overcoming of negative tendencies for proprietors and managers.

The control content is defined by its objects. Vihansky O. and Naumov A.⁵⁹ allocate accounting as separate internal process of six groups of functional processes which cover activity of any enterprise. Also Bushmeleva G⁶⁰. agrees with these authors she allocates such processes, as production, marketing, finance, human recourses, innovations, investments, logistics, quality. Agreeing with the given "process" approach it is possible to make a conclusion that it is necessary to consider accounting as an object of quality control of the financial reporting consisting of the financial accounting and process of the financial reporting preparation.

Domestic and foreign experts give various definitions of the internal control concept, including object, subject, purposes and forms of the internal control. By R.I.Krinitzky's definition, the control is a process of supervision and check of industrial and financial and economic activity of the enterprises, carried out by corresponding subjects of management for revealing of deviations from the established parametres of this activity, removal and the prevention of the negative phenomena and tendencies. In V.G.Afanasev's work offers following definition of the control: The control is a work on supervision and a compliance test of functioning process object made decisions to laws, plans, norms, standards, rules, orders etc., to revealing of results of effect of the subject on the object, the admitted deviations from requests of administrative decisions, from organisation and regulation principles⁶¹. According to V.I.Benediktova, the control is a complex studying of various aspects of activity of the enterprise: economic efficiency and legitimacy of carried out economic operations, reliability of the registration and accounting information on economic and financial actions by comparison to an actual state of objects of the control. According to Belobzhetsky I.A., the accounting intraeconomic control as one of management functions represents a watch system and checks of financial and economic activity of the enterprise, its inter-productional and other structural divisions for the purpose of the impartial assessment of economic validity,

⁵⁹ Vihanskii O.S., Naumov A. I. *Menedzhment : Praktikum po kursu*. 2002. p. 281

⁶⁰ Bushmeleva V.G. *Adaptivnoe upravlenie promyshlennym predpriyatiem v konkurentnoi ekonomike*. UrO RAN. 2008. p. 215

⁶¹ Pyatov M.L., Smirnova I.A. *Princip konservatizma*. // BUH.1S. 2007. № 3. p. 40

financial productivity and legitimacy of the made decisions and results of their carrying out, and also with the purposes of revealing of deviations from requests of these decisions, removal of adverse economic situations and the alarm system about them to proprietors, administration, advice (board) of the enterprise, chiefs of its structural divisions.⁶² In presented doctoral thesis, it is necessary to treat the control as supervision. Supervision is a general scientific method of information gathering, by direct registration by the researcher of event, the phenomenon, and processes occurring in certain conditions. Basic methods of supervision of the financial reporting quality control are studying of documents, interrogation, questioning, realisation of examinations, studying of processes, and their analysis. A control end result is financial reporting quality evaluation on conformity to qualitative characteristics, its analysis and working out of recommendations.

Hence, it is possible to name reporting quality control the process of realisation of constant supervision over the system of the accounting, and also over the major current processes of financial and economic activity and the analysis of their influence on qualitative characteristics of the financial reporting in the conditions of constantly varying external and internal environment. The control purposes are:

- an estimation and analysis of factors influencing quality of the financial reporting;
- duly detection of deviations of the data in the reporting from actual results of activity,
- definition of articles causing distortion of real financial circumstances of the enterprise,
- revealing of size of influence of the given distortions on the reporting, and also revealing of the reasons causing these deviations and distortions,
- reporting quality evaluation on conformity to qualitative characteristics for support of decision-making.

And also, facing the control it is necessary to add the working out of recommendations to problems corresponding to separate directions of an internal control system for financial reporting quality improvement.

⁶² Berkovich V., Koptelov A.K. *Prozrachnaya otchetnost'. Kak postroit' effektivnyuyu sistemu vnutrennego kontrolya. // Risk-menedzhement. 2007. № 5-6*

3 THEORETICAL POSITIONS ON METHODOLOGICAL ASPECT OF QUALITY ASSURANCE OF THE FINANCIAL REPORTING

3.1 A place of quality control of the reporting in an enterprise management structure

3.1.1 Internal control concept

The internal control is organized on means of the managing subject in any enterprise under the decision of a management for management and accounting efficiency. The information of the intrafirm control is used, as a rule, by a management. All plots and structural divisions of the managing subject are exposed to the intraeconomic control, it covers all financial and economic and enterprise productive activity as a whole.⁶³

It is necessary once more to establish that scientists and experts give various definitions to system of the internal control (see table 3).

Table 3. Definitions of system of the intrafirm (internal) control

Definition	Source
Includes techniques and procedures of three basic categories which are developed and used by the management to ensure the sufficient warranty of conformity to the control purposes: the control environment, accounting system, the control moments (procedures).	[4, p. 264]
Includes three basic elements: the control environment, accounting system, control procedures.	[23, p. 47].
It is organized by management in order: to carry out enterprise activity in order and effectively; to ensure management policy observance; to ensure safety of property; to reach qualitative documentation of operations.	[1, p. 128]
Represented by set of organizational structure, techniques and the procedures accepted by chiefs of the organization for the control of efficiency of economic activities. The organization internal control system joins three components: the control environment, accounting system, control procedures.	[10, p. 100]
Includes a complex of the diverse interconnected techniques and procedures which are developed and used by the management to ensure undesirable risk decrease in business and financing activities, and also in the accounting and the reporting.	[72, p. 57]
Represented by the set of the management purposes for the employees, and consist of those concepts on the base of which the management proceeds.	[34, p. 165]
It is defined as a set of organizational measures, techniques and the procedures applied by a management of the economic subject for ordered and effective conducting of economic activities. Consists of an accounting system, the control environment, control devices.	[12, p288-289]
Represented by the set of organizational measures, techniques and the actions applied by a management and workers of the economic subject for successful and effective conducting of	[21, p.156]

⁶³ Andreev V.D., Cheremshanov S.V. *Sistema vnutrihozyaistvennogo kontrolya: osnovnye ponyatiya* // Auditorskie vedomosti. 2004. N 2

economic activities.	
Includes a proper accounting system, the control environment, separate control devices.	[28, p.143]
Includes a proper accounting system, the control environment, control procedures.	[106, p.4.1]
Represented by the difficult and thin organism which integral parts are all divisions of the enterprise, its all spheres of activity and activity of each worker of the enterprise.	[37, p. 10]
It is defined as a set of organizational structures, techniques and the procedures accepted by a management of the economic subject for ordered and effective conducting of economic activities which is organized in the given economic subject and its forces supervision and check: observance of requests of the legislation; accuracy and completeness of the documentation of accounting; timeliness of preparation of reports; prevention of errors and distortions; performances of orders and charges; maintenance of safety of property of the organization.	[31, p.342]
Can be subdivided into three components: the control environment - a set of characteristics which defines the office mutual relations favorable for the control in the company; a company accounting system - a policy and the procedures, concerning corresponding record of economic operations; control procedures - the special audits executed by staff of the company.	[31, p.137]
Includes three elements: monitoring procedure conditions, an accounting system and control procedures.	[14, p.155].

From table 3 it is visible that the majority of experts agree in opinion that all variety of the actions which are carried out for the organization of the internal control is conditionally possible to group on three blocks:

- a proper accounting system;
- the control environment;
- separate control devices.

The analysis of documents from practice [80, 81, 82, 83, 84, 86, 88, 89, 98, 100], and also the report⁶⁴ shows that in essential aspects modern definition of subsystems of the internal control (in particular, in the document of Basel committee "the Internal control in banks: organisation bases", in standards SAS 55/78/94) is based on the definition formulated COSO (1992)⁶⁵ in which following subsystems of the internal control are allocated:

- Management of risks;
- The internal environment;
- Control procedures or control devices;
- The information and communications;
- Monitoring.

The indicated componental set is concretised depending on the corresponding purposes of the internal control (operational, financial, and so on) and check directions (function, divisions) which represent corresponding layers of "COSO cube" (picture 7).

⁶⁴ Janet L. Colbert, Paul L. Bowen *Comparison of Internal Controls: COBIT, SAC, COSO and SAS 55/78*. // IS Audit and Control Journal. 1996. № IV, p. 26-35

⁶⁵ Committee of Sponsoring Organizations of the Treadway Commission *Internal Control —Integrated Framework. Guidance on Monitoring Internal Control Systems*. Discussion Document. September 2007. <www.coso.org>



Picture 7. Cube «COSO»

Internal control consists of five interrelated components. These are derived from the way management runs a business, and are integrated with the management process. Although the components apply to all entities, small and mid-size companies may implement them differently than large ones. Its controls may be less formal and less structured, yet a small company can still have effective internal control. The components are:

Control Environment

The control environment sets the tone of an organization, influencing the control consciousness of its people. It is the foundation for all other components of internal control, providing discipline and structure. Control environment factors include the integrity, ethical values and competence of the entity's people; management's philosophy and operating style; the way management assigns authority and responsibility, and organizes and develops its people; and the attention and direction provided by the board of directors.

Risk Assessment

Every entity faces a variety of risks from external and internal sources that must be assessed. A precondition to risk assessment is establishment of objectives, linked at different levels and internally consistent. Risk assessment is the identification and analysis of relevant risks to achievement of the objectives, forming a basis for determining how the risks should be managed. Because economic, industry, regulatory and operating conditions will continue to change, mechanisms are needed to identify and deal with the special risks associated with change.

Control Activities

Control activities are the policies and procedures that help ensure management directives are carried out. They help ensure that necessary actions are taken to address risks to achievement of the entity's objectives. Control activities occur throughout the organization, at all levels and in all functions. They include a range of activities as diverse as approvals, authorizations, verifications, reconciliations, reviews of operating performance, security of assets and segregation of duties.

Information and Communication

Pertinent information must be identified, captured and communicated in a form and timeframe that enable people to carry out their responsibilities. Information systems produce reports, containing operational, financial and compliance-related information, that make it possible to run and control the business. They deal not only with internally generated data, but also information about external events, activities and conditions necessary to informed business decision-making and external reporting. Effective communication also must occur in a broader sense, flowing down, across and up the organization. All personnel must receive a clear message from top management that control responsibilities must be taken seriously. They must understand their own role in the internal control system, as well as how individual activities relate to the work of others. They must have a means of communicating significant information upstream. There also needs to be effective communication with external parties, such as customers, suppliers, regulators and shareholders.

Monitoring

Internal control systems need to be monitored - a process that assesses the quality of the system's performance over time. This is accomplished through ongoing monitoring activities, separate evaluations or a combination of the two. Ongoing monitoring occurs in the course of operations. It includes regular management and supervisory activities, and other actions personnel take in performing their duties. The scope and frequency of separate evaluations will depend primarily on an assessment of risks and the effectiveness of ongoing monitoring procedures. Internal control deficiencies should be reported upstream, with serious matters reported to top management and the board.

There is synergy and linkage among these components, forming an integrated system that reacts dynamically to changing conditions. The internal control system is intertwined with the entity's operating activities and exists for fundamental business reasons. Internal

control is most effective when controls are built into the entity's infrastructure and are a part of the essence of the enterprise. "Built in" controls support quality and empowerment initiatives, avoid unnecessary costs and enable quick response to changing conditions.

There is a direct relationship between the three categories of objectives, which are what an entity strives to achieve, and components, which represent what is needed to achieve the objectives. All components are relevant to each objectives category. When looking at any one category - the effectiveness and efficiency of operations, for instance - all five components must be present and functioning effectively to conclude that internal control over operations is effective.

The internal control definition - with its underlying fundamental concepts of a process, effected by people, providing reasonable assurance - together with the categorization of objectives and the components and criteria for effectiveness, and the associated discussions, constitute this internal control framework.

What Internal Control Can Do

Internal control can help an entity achieve its performance and profitability targets, and prevent loss of resources. It can help ensure reliable financial reporting. And it can help ensure that the enterprise complies with laws and regulations, avoiding damage to its reputation and other consequences. In sum, it can help an entity get to where it wants to go, and avoid pitfalls and surprises along the way.

What Internal Control Cannot Do

Unfortunately, some people have greater, and unrealistic, expectations. They look for absolutes, believing that: internal control can ensure an entity's success - that is, it will ensure achievement of basic business objectives or will, at the least, ensure survival. Even effective internal control can only help an entity achieve these objectives. It can provide management information about the entity's progress, or lack of it, toward their achievement. But internal control cannot change an inherently poor manager into a good one. And, shifts in government policy or programs, competitors' actions or economic conditions can be beyond management's control. Internal control cannot ensure success, or even survival. Internal control can ensure the reliability of financial reporting and compliance with laws and regulations. This belief is also unwarranted. An internal control system, no matter how well conceived and operated,

can provide only reasonable - not absolute - assurance to management and the board regarding achievement of an entity's objectives. The likelihood of achievement is affected by limitations inherent in all internal control systems. These include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the collusion of two or more people, and management has the ability to override the system. Another limiting factor is that the design of an internal control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Thus, while internal control can help an entity achieve its objectives, it is not a panacea.

Roles and Responsibilities

Everyone in an organization has responsibility for internal control.

Management. The chief executive officer is ultimately responsible and should assume "ownership" of the system. More than any other individual, the chief executive sets the "tone at the top" that affects integrity and ethics and other factors of a positive control environment. In a large company, the chief executive fulfills this duty by providing leadership and direction to senior managers and reviewing the way they're controlling the business. Senior managers, in turn, assign responsibility for establishment of more specific internal control policies and procedures to personnel responsible for the unit's functions. In a smaller entity, the influence of the chief executive, often an owner-manager, is usually more direct. In any event, in a cascading responsibility, a manager is effectively a chief executive of his or her sphere of responsibility. Of particular significance are financial officers and their staffs, whose control activities cut across, as well as up and down, the operating and other units of an enterprise.

Board of Directors. Management is accountable to the board of directors, which provides governance, guidance and oversight. Effective board members are objective, capable and inquisitive. They also have a knowledge of the entity's activities and environment, and commit the time necessary to fulfill their board responsibilities. Management may be in a position to override controls and ignore or stifle communications from subordinates, enabling a dishonest management which intentionally misrepresents results to cover its tracks. A strong, active board, particularly when coupled with effective upward communications channels and capable financial, legal and internal audit functions, is often best able to identify and correct such a problem.

Internal Auditors. Internal auditors play an important role in evaluating the effectiveness of control systems, and contribute to ongoing effectiveness. Because of organizational position and authority in an entity, an internal audit function often plays a significant monitoring role.

Other Personnel. Internal control is, to some degree, the responsibility of everyone in an organization and therefore should be an explicit or implicit part of everyone's job description. Virtually all employees produce information used in the internal control system or take other actions needed to effect control. Also, all personnel should be responsible for communicating upward problems in operations, noncompliance with the code of conduct, or other policy violations or illegal actions.

A number of external parties often contribute to achievement of an entity's objectives. External auditors, bringing an independent and objective view, contribute directly through the financial statement audit and indirectly by providing information useful to management and the board in carrying out their responsibilities. Others providing information to the entity useful in effecting internal control are legislators and regulators, customers and others transacting business with the enterprise, financial analysts, bond raters and the news media. External parties, however, are not responsible for, nor are they a part of, the entity's internal control system.

One of the most essential aspects without which the estimation and comparison of various aspects of an internal control system are problematic, is necessary to recognise necessity of definition of basic terminology on which basis would be possible to show components and procedures of the internal control any management structure and business processes.

3.1.2 Financial reporting quality control concept

Thus, it is observed the distinct and well-founded convergence which allows to draw with certain degree of optimism a conclusion that the toolkit problem basically is opened.

The analysis of documents and definitions resulted in table 3, and also result received during the joint analysis of definitions of an internal control system with the employee of chair "Finance" of Technological University of Brno M.Pernica according to the Czech,

Russian and international standards⁶⁶ allows to make a conclusion that the system of the internal control is presented in the form of a complex of the ordered interconnected measures, techniques and procedures which are used by employees, divisions and a management of the managing subject with the purposes of maintenance of observance of management policy, safety of property, effective economic activities, observance of the established requests and granting of the qualitative reporting. The internal control is carried out by forces of the concrete economic subject for constant surveillance and check of made operations, acceptance of operative action. IC includes the control environment, an estimation of risks, control procedures, the information and communications, monitoring. Thus the concrete internal control and its efficiency depends on methods of activity of the economic subject, the organization and "the know-how", an order of the gathering, processing and the analysis of the information and other factors.

From the aforesaid follows that constant internal quality control of the financial reporting does not replace IC, and also obligatory audit and as well as external and internal audit, and it is just one more protection frame of information interests of the proprietor, investor and manager.

The primary goal of quality control of the financial reporting as control procedure to monitor that external and internal factors did not influence negatively to quality of the financial reporting of an enterprise, and management granted the qualitative information to users. At first sight the given functions practically coincide with internal audit or IC functions. Quality evaluation of the economic information is one of problems facing to internal audit. However essential defect of internal audit, its attachment to enterprise structure, subordination to its management and complete material dependence on it, and also as the internal audit purposes wider problems such as IC estimation and its efficiency, rendering of advisory services etc. At the same time in construction of the high-grade system of the constant intraeconomic control the functions of quality control can be carried out by internal audit. Essential difference offered systems from internal audit is that reporting quality control, as well as accounting, has continuous character.

Constantly functioning body is necessary for control of reporting in a proper kind, which:

⁶⁶ Ing. Pernica Martin, Ing. Timur Gafarov *System vnitřní kontroly*. MendelNet 2007. p. 108-109. ISBN 978-80-903966-6-1

- can be represented by the commission members who are representatives of different structural divisions of the enterprise and also independent experts;
- can be a division part of IC (Internal Control) or IA (Internal Audit) or functions of quality control of the reporting can be executed by employees of the above-stated departments;
- can be a division of the enterprise or group of the enterprise (in a case of obligatory consolidation only in exceptional circumstances) and obey directly to the board of directors, being representatives of proprietors (dependence of service of the internal control on management stipulates a formalism of estimations of results of conducted checks, absence of recommendations, the formal control over removal of the infringements revealed at checks, an emphasis in work on consultation. In these conditions in work there is no mutual trust that as a whole does not promote strengthening of the internal control);
- or to represent the independent legal body as a part of the enterprise;
- or to represent the independent legal body out of the enterprise.

In the last case the independent consulting (auditor) firm can incur control functions.

The complete submission of control of the financial reporting quality functions to the director is possible only in that unusual case when the chief is the unique proprietor of the company. As to control realization in a continuous order, here is a same problem, as in case of book-keeping - to ensure an optimum parity of efficiency of action of the control and expenses for its contents. It is enough to enter certain criteria and importance levels on groups of operations.

Control of the financial accounting quality and carries out control and correcting functions behind accounting department. The place of quality control of the financial reporting in a management structure of the enterprise and of the informational flows can look how is shown in picture in the appendix 4.

Thus, the structural organisation of accounting system is understood as a set of the basic and auxiliary registration processes which organisation purpose is satisfaction of information requirements of users by transformation of the primary information to a resultant accounting information according to the set of standard-legal, methodical and organizational maintenance with involvement of necessary resources. We will underline that the purposes of the organisation and functioning of the accounting system are defined, seted and installed by high level systems, namely a management system of the enterprise and its environment. Thus financial reporting quality assurance is a part of global system of the intraeconomic control and situated on exit of IC, and urged to meet the requirements of users to financial reporting qualitative characteristics.

General requirements of the quality control of the reporting include requests on the organisation of system of quality on the basis of the process approach, and also a request on documentating.

Introduction of an additional link in the enterprise management system leads to its complication and, unconditionally, increases expenses for realisation of control actions. However these expenses are justified, as necessary scope, a continuity of the control and efficiency in presenting of the qualitative economic information to representatives of proprietors of the organisation, management and other interested persons in this case is ensured.

The control of quality of the financial reporting should be reactive, than proactive (as a result the enterprise struggles with consequences of negative events more often, instead of to warns). It is very important, that reaction to negative events was operative.

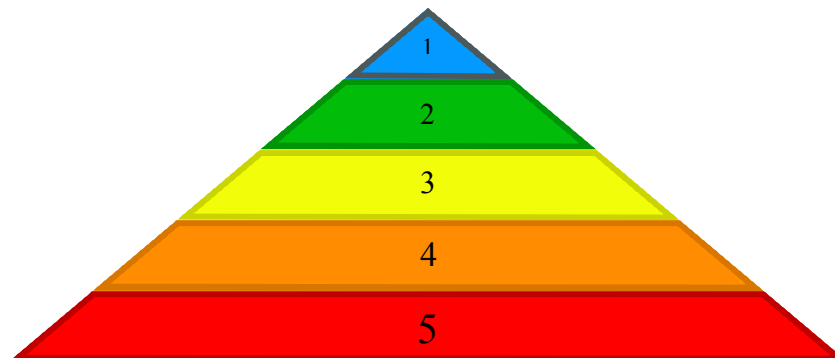
Delay of receipt of the data from the control leads to that in hardly changed conditions the planned actions will lose their meaning. Application of out-of-date correcting effects on a supernumerary situation only will aggravate conditions.

Frequently counteraction plans are developed proceeding from the assumption that events occur consistently one after the other. But in a reality incidents can happen simultaneously. Therefore the quality control should include the debugged procedure of an establishment of priorities of the importance of events for an enterprise.

To recognise reporting quality control effective is possible only in the case, if the given kind of the control at least is capable to define the qualitative reporting to identify factors influencing quality of the financial information, to evaluate them, to classify and then to start managerial process of correction. Besides, the control can execute also a function of a feedback for change managerial process , proving the made decision and correcting effect.

The financial reporting quality control is not recommended to be considered exclusively as the constituent only financial management which is focused only on the financial reporting. The set of accounts should not become the basic reference point for control introduction, at that time when the given system should be directed on satisfaction of requirements of business processes and decision-making. At more effective approach

integration of the control of quality of the financial reporting should be deeper and cover all enterprise (picture 8).



Picture 8. Control levels

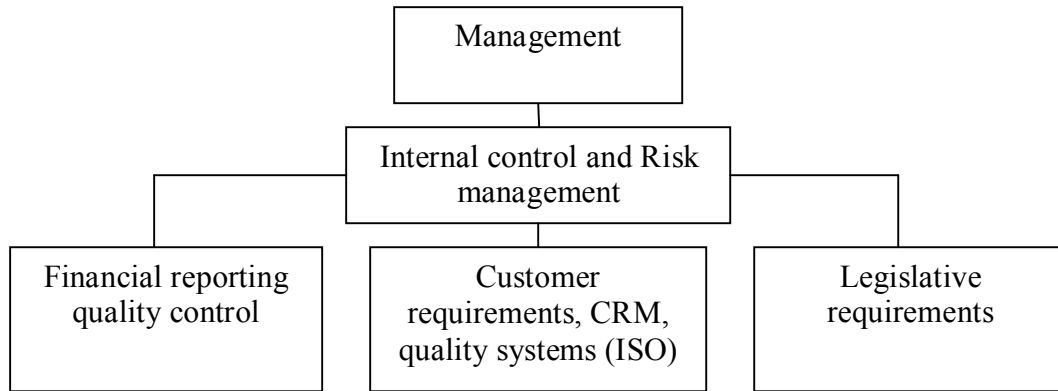
1. The Top-manager is personally liable for reliability of the financial reporting and efficiency of functioning of the internal control
2. The internal control necessary for reliability and accuracy maintenance.
3. For reliability and ordering process should be defined and registered.
4. An effective system of the document circulation.
5. Various integral instruments and systems.

From the point of view of management, requests of quality control of the reporting can be similar to many requests of the legislation or other standards, and also various systems of quality. They contain:

- accurately certain control system and processes;
- the anticipatory approach to management of risks and the problems solving;
- accurately certain responsibility for performance;
- a self-estimation and self-checking.

The industrial enterprise can introduce the IC which will ensure achievement of various requests: proprietors, standards, the legislation etc. (picture 9). The result of introduction of such system can be considered also as improvement in integration of management accounting with financial, more comprehensive approach to management of risks, higher efficiency in achievement of conformity to standards and wider base for development.

Enterprises using approaches of deeper integration understand business functioning as difficult system better.



Picture 9. Internal control in operation of business

Quality control of the reporting of the enterprise is a part of a control system of the enterprise, specially organised target continuous supervision over preparation process, use and granting of the reporting of the enterprise for its analysis and decision-making on its basis.

The purpose of quality control of the reporting is the gathering, studying and preparation of the information for definition of quality of the reporting created for decision-making. It stipulates two features with which should satisfy the control as gathering and information handling system: a target orientation of information processes and the maximum objectivity of received conclusions at each stage of data processing.

Basic elements of the quality control of the enterprise are: the subject – the user of the reporting; object – accounting department, the financial accounting etc.; functions management and action.

The reporting quality control takes the important place in operation of business, is the subsystem of administrative and control structures of the enterprise using and ensuring communication between all subsystems and an environment.

The control becomes the real factor of management, and represents certain process, therefore it should be organised. From the point of view of the quality assurance organisation there is a necessity for integration of quality control of the reporting for administrative and control structure of the enterprise, and also delegation of responsibilities to experts which problem would include working out of methodology and a monitoring technique.

3.2 Methodical aspects of quality control of the financial reporting.

3.2.1 Technique general requirements.

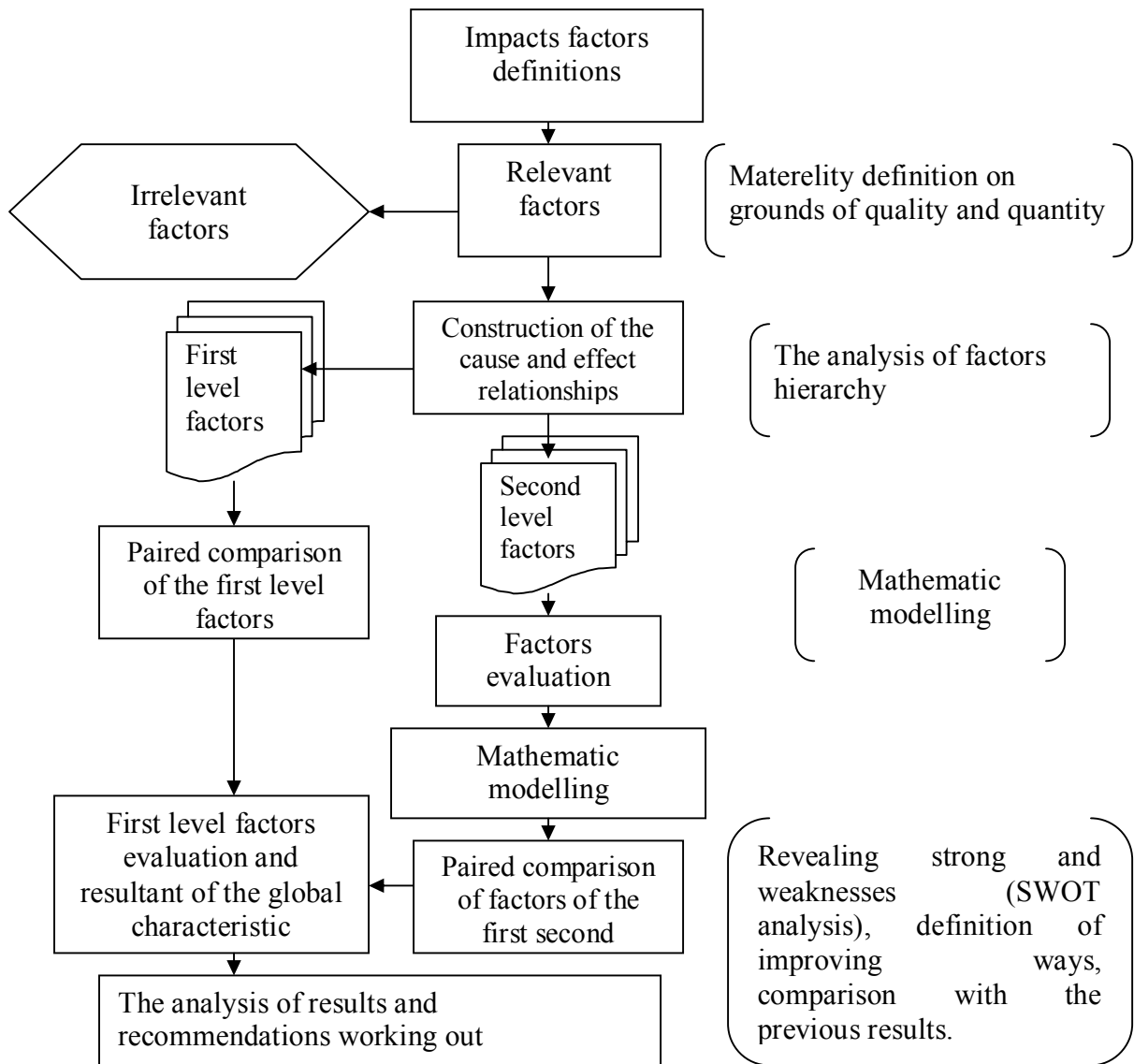
Features of quality control of the financial reporting make certain demands to structure, designated purpose and quality of used mathematical and tool models. Reporting quality control as complete system of continuous supervision, and the analysis of processes should become a necessary link during reporting preparation, and also at making and control of decisions at the enterprise. Thus deeper studying of a question of construction and control implementation has shown that for avoidance of difficulties and errors it is necessary to consider following requests:

- the impartial assessment of work volumes (underestimation frequently takes place);
- special attention to processes and their description;
- implementation just «for the sake of appearance» which will not be effective;
- compulsory use as control procedures and analysis of risks;
- availability of training;
- desirable use by IT decisions in the field;
- use of differentiation of authorities (including in information systems);
- perception of works not as a project, but as a process of the internal control.

Implementation of quality control of the financial reporting as internal control system element is a complex problem and is connected with essential expenses. It is necessary to perceive works on construction of quality control of the reporting and an internal control system as regular business process. As the relation to the given problem as to the single project will not bring required result – the qualitative financial reporting. In picture 10 the process block diagramme of quality control of the financial reporting is presented.

Use of the process focused approach at control system construction in aggregate allows to construct process of the internal control which besides conformity to various standards, will bring huge advantage and will bring an enterprise to qualitatively new level of management.

The control should be made in follow stages:



Picture 10. Block-scheme of the financial reporting quality control

Stage 1. Revealing of all the factors influencing on the reporting quality. It is necessary for a commission of experts using the method of “brain storm” to make the list of all possible internal and external factors influencing on the financial reporting quality. It is necessary to be guided by factors which influence directly on separate qualitative characteristics or on the reporting as a whole.

Stage 2. Allocation of the most significant factors. At the given stage conducting the control it is necessary for group of experts to make the analysis and ranging of the allocated factors for definition of the most essential. The level of relevant should be taken in not just like quantitative characteristic but first of all as a qualitative. Thus, importance of the factor is understood as a possibility of its influence on the financial reporting in such a manner that the

given influence can lead to the change of information user opinion. The received results can be presented as the following table 1:

Table 4. Relevant factors

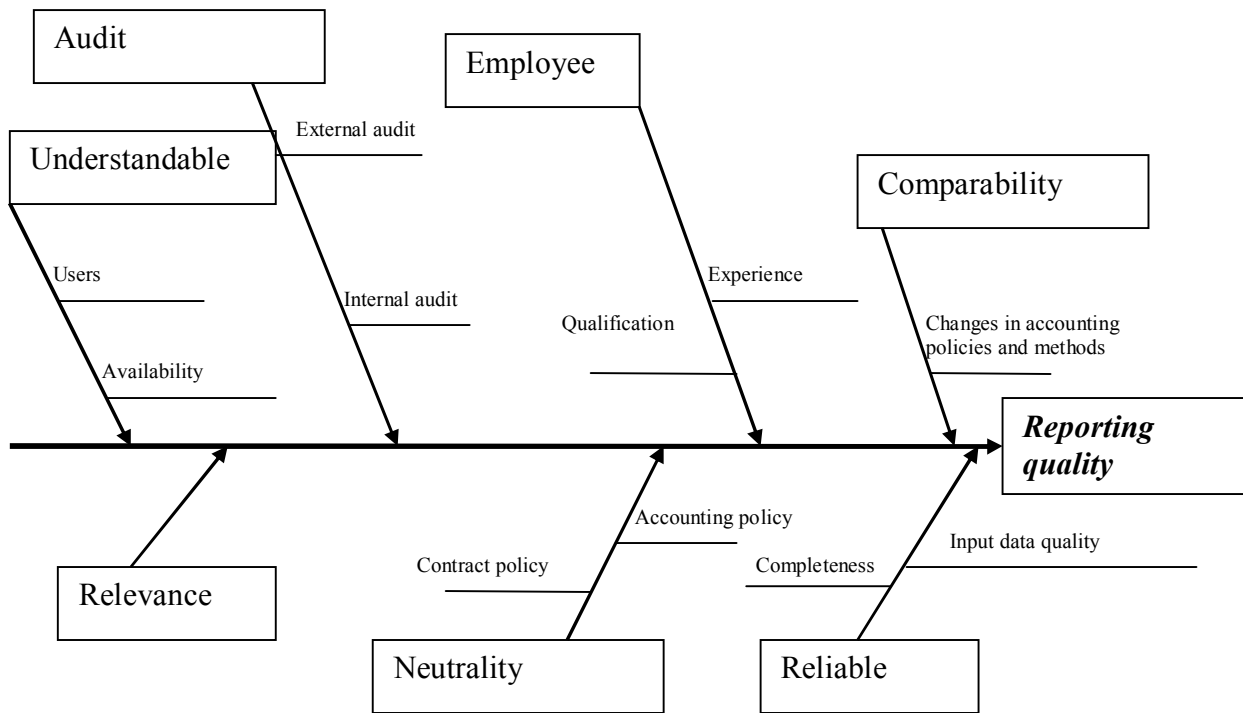
First level factors	Second level factor
Neutrality	Contract policy
	Accounting policy
Relevant	relevance
	materiality
Understandable	Users attainments
	availability
Audit quality	External audit quality
	Internal control quality
Employee	Qualification
	Experience
Comparability	Changes in accounting policy
	Changes in accounting methods
Reliability	Risks
	Distortion indicators
	Reports intercommunication
Completeness	Completeness of all activities
Organizational culture	Top and middle managers reporting quality understanding
	Personal responsibility

Stage 3. Construction of the factors relationship. Construction of the factors relationship “fish” reflecting which shows influence of factors on quality of the reporting (the analysis of hierarchy).

Further it is necessary to construct a relationship of cause and effect reflecting interrelations and influence of factors on the reporting quality. For a task solution of working out of a technique experts consider expedient use of the cause and effect diagramme (“fish”), offered the Japanese scientist Kaom Ishikava⁶⁷. On its basis the structure of a problem emerges and base interrelations between factors of the first and second order can be defined. Next, for each paramount factor of the second and third usages influencing factors of the first order should be defined.

In picture 11 the example with some factors is presented. The constructed cause and effect diagramme allows to see structural interrelation of the basic and minor factors, hallmarking the reporting, and their effect on an end result.

⁶⁷ Ishikava K. *Yaponskie metody upravleniya kachestvom*. 1988. p. 103



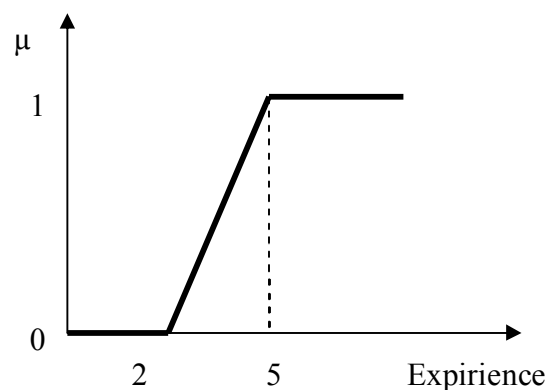
Picture 11. Hierarchy of quality influencing factors

Stage 4. An estimation of minor factors. At the given stage it is necessary for experts to estimate all factors of the second order. For an example, the criterion "Experience" relied corresponding to term of work. We count, that an operational experience on a site of work or as a whole in accounts department smaller, than two years it is undesirable. As much as possible experience is got for five years.

Stage 5. Mathematical model of an estimation of factors of the second order.

Modeling is offered to be carried out with use of desirability functions.

For an example factor "Experience". Corresponding function of desirability of criterion "Experience" is resulted in figure 3.



Picture 12. Function of desirability for the factor "Experience"

The formula of function of desirability can be deduced using any mathematical tool for this purpose, and also with help of MS Excel.

Function of desirability for the factor "Experience" will look as follows:

$$\mu \begin{cases} \mu = 0, (0 \leq x < 2) \\ \mu = 1/3x - 2/3, (2 \leq x < 5) \\ \mu = 1, (x \geq 5) \end{cases} \quad (1)$$

Solving simple system of the equation it is possible to determine μ . By results of an estimation it is necessary to construct under all factors of the second level the table with the received results of function of desirability.

Table 5. Function of desirability for factor "Experience"

Factor	Meaning	μ
Experience	3 years	1/3 or 0,333(3)

Stage 6. Construction of matrixes of factors paired comparisons. Construction of the factors paired comparisons matrixes is built on the method of T. Saaty⁶⁸. An example of comparisons is resulted in table 6 (an example for criterion "Personnel").

A technique of the ranks finding of second level criteria on the basis of a pair comparisons matrix. A - the matrix of the pair comparisons constructed on the basis of values determined by experts of elements of a matrix a_{ij} . Through $\alpha_1, \alpha_2, \dots, \alpha_n$ is designated required values of factors of the relative importance of factors. $W = (\alpha_1, \alpha_2, \dots, \alpha_n)$ - a vector of factors of relative importance (ranks); n - amount of second level criteria.

For each element of a pair comparisons matrix fairly $a_{ij} = a_i a_j$. On substantial sense ranks α_i are values of contributions of corresponding second level factors, differently factors of importance of these criteria.

The wide circulation for search of ranks of factors on the basis of a matrix of pair comparisons was received with the approached method suggested by T. Saaty.

$$\alpha'_i = \sqrt[n]{\prod_{j=1}^n \alpha_{ij}}, \quad \alpha_i = \alpha'_i / \sum_{i=1}^n \alpha'_i \quad (2)$$

⁶⁸ Saati T. *Prinyatie resheniya. Metod analiza ierarhii*. 1993. p. 278.

Approached method T. Saaty⁶⁹ has received a wide circulation thanks to its simplicity.

Thus, a matrix of paired comparisons of the factor "Personnel", and also ranks it is possible to present as table 6.

Table 6. Matrix of paired comparisons for the factor "Personnel"

Personnel	Qualification	Experience	Rank
Qualification	1	1/3	0,366
Experience	3	1	0,634

The given table is a result of ranking and shows on how many these or that factor, according to experts estimation, is more important than other.

Stage 7. Construction of a paired comparisons matrix for the first level factors.

At this stage a matrix of pair comparisons should be constructed for the first level factors and their ranks are designed. Construction of a matrix of paired comparisons and calculation of ranks is carried out similarly to a way submitted in the fifth stage.

For example the experts are needed to construct a paired comparisons matrix for factors of the first level. They have defined, that a neutrality is almost equivalent to the personnel and it is a little bit more preferable than quality of audit, and quality of audit is a little bit more preferable than the personnel. Having constructed a matrix, experts have defined ranks under the formula 2. The received result is submitted in table 7.

Table 7. Matrix of paired comparisons of factors of the first order

Reporting quality	Employee	Neutrality	Audit quality	Rank
Employee	1	1/2	1/3	0,1634
Neutrality	2	1	3	0,5396
Audit quality	3	1/3	1	0,297

Stage 8. Convolution of the first level factors and an estimation of a global parameter of quality of the financial reporting. At the given stage it is carried out (in view of the found ranks) curtailing of the second level factors in factors of the first, then factors of the first level in the uniform global criterion describing the general quality of the reporting.

⁶⁹ Saati T., Kerns K. *Analiticheskoe planirovanie. Organizaciya sistem.* 1991. 224 p

Calculation of the first level factors value is made under the following formula

$$D(C_1, C_2 \dots C_n) = \frac{(a_1 \mu(C_1) + a_2 \mu(C_2) + \dots + a_n \mu(C_n))}{n}, \quad (3)$$

where D - an estimation of the factor of the first level;
 C - factors of the second level which are included in the considered first level factor;
 α - a rank of the corresponding factor of the second level;
 μ - value of desirability function for corresponding the second level factors;
 n - quantity of factors of the second level.

The received results should be fixed in the summary table.

Table 8. Criteria of quality of factors of the second order

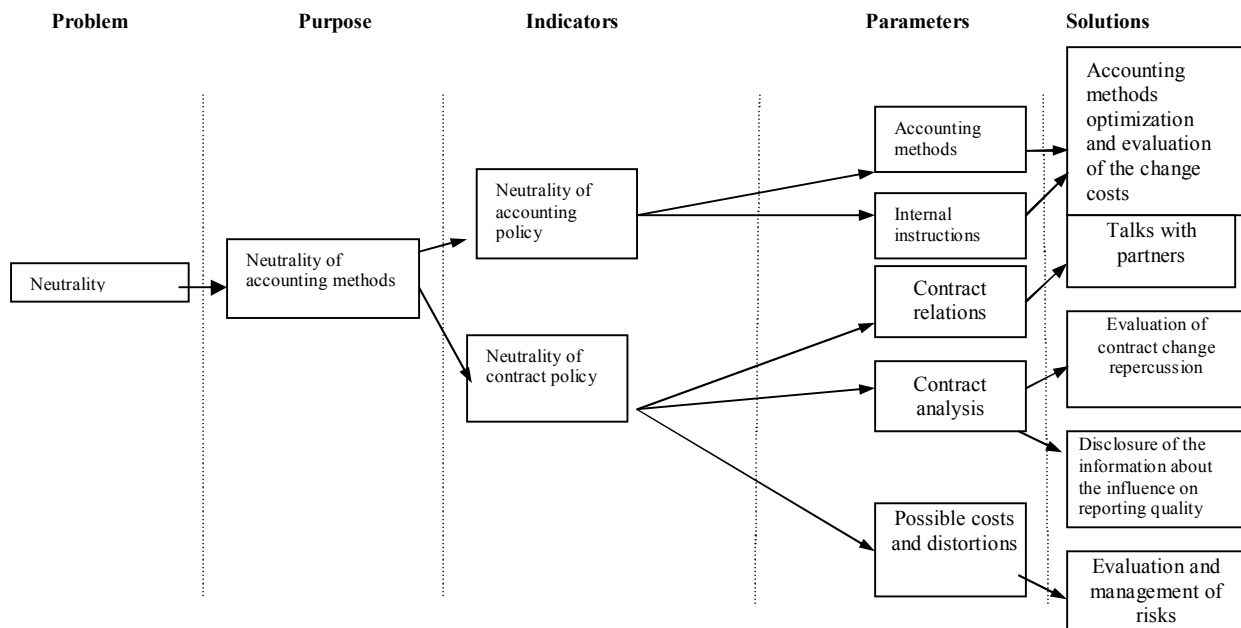
First level factor	Second level factors	μ	Second level factor rank	First level factor estimation	First level factor rank
Employee	Experience	0,33	0,366	0,308	0,1634
	Qualification	0,78	0,634		

According to the offered table it is possible to estimate factors of the first level, balance between qualitative characteristics, to see weak and strengths of the financial reporting, etc. In an analyzed situation it is visible, that for improvement of quality of the financial reporting it is necessary to lead training of the personnel or to replace with more qualified and skilled staff.

For definition of a global parameter of the financial reporting it is necessary using the formula 3 to carry out convolution of all factors of the first level to global criterion of quality of the financial reporting.

Stage 9 Analyses of results and recommendations. At the final stage the estimation of reporting quality which, in a consequence, will allow to make improvement of system of the internal control and control procedures is given.

Typical recommendations can be made on a base of the following example scheme presented in the picture 12.



Picture 12. Recommendation working out scheme

It would be desirable to note, that process of an estimation and perfection of the internal control system should occur continuously and its revision should be made constantly, instead of results of annual audit. Thus, results of quality assurance of the financial reporting are the entrance information for construction and continuous improvement of the internal control system process.

3.3 Some factors valuation methods

There are various methods of valuation of influencing factors. Further some factors influencing quality of the financial reporting and methods of their estimation are considered.

3.3.1 The analysis of the financial indexes as the judgment instrument about reliability of the financial reporting.

According to the KPMG research conducted in 2007, 86 % of fraud cases took the lowest and average management items and only 60 % of cases belonged to top.⁷⁰ However losses from actions of chiefs are much more notable. For example, at popular among the junior labour „billing“ (nonexistent accounts and services are paid or not taking place costs are refunded) average losses seldom exceed \$100 000. At operations on a conclusion of cashless means to personal accounts and misappropriation of securities holders can already miss from \$500 000 to \$2 million. General directors represent the greatest threat for operation of the company.

In KPMG even have introduced some factors which do a life of corporate werewolves especially comfortable. So, the companies using the schemes of cashing in of money for minimisation of the taxation, quite often lose much more essential sums because of abusings of employees. The high share of cash payments in a business economics complicates a problem of search of interested persons. "Slate club" costs frequently cannot be checked in view of absence of confirming documents that creates the favorable environment for abusings. We will admit, in Europe where the lion's share of accounts is carried out in the cashless form, to prove the fact of fraud much easier. Besides, in the majority of the companies accounts department activity carries process character, that is reduced only to duly reflexion of financial transactions and reporting preparation. In the West besides settlement it executes also control function that allows to reveal infringements periodically. But in Russia and or more or lees in The Czech Republic the accounts department is actually deprived of civil rights, with its opinion are considered no means always. Even if

⁷⁰ Akulov A.V., Malyhin D.V., Ryzhih N.N. *K voprosu o standartizacii processov upravleniya riskamii vnutrennego kontrolya // Upravlenie v kreditnoi organizacii.* 2007. N 1.

"accountants" distinguish in time frauds, chiefs of departments and the top management quite often force them to accept documents for payment⁷¹.

Unconditionally, completely to win corporate fraud is impossible. It is indicative that, for example, in Great Britain where for a long time already struggle with office werewolves, in 2006 in comparison with 2005 share of frauds has increased more than on 35 %. Proprietors still have only one exit - as much as possible to complicate a life to unscrupulous employees. Proprietors need to choose only, what protective measures approach for concrete business.

The fraud prevention is the most important party of all problem considered by us, allowing to save the big means. If swindle is made, there are no any more. Swindlers appear in lost that suffer indignity also contempt of associates, not to mention punishment. Swindle investigation can appear very expensive action. Those organisations and physical persons which undertake active measures for the prevention of fraud cases, usually find out that it brings the big financial prize.

Effectively to reduce quantity of abusings as those, it is necessary to eliminate one or more of those three elements of a triangle of swindle. These elements are pressure of external circumstances, possibility and the self-justification. At removal or reduction of possibility of the self-justification and this pressure the probability of fulfilment of roguish actions much more decreases.

For the prevention or revealing of swindle by the most effective the actions directed on creation in firm or the organisation of special control authorities are represented. These bodies should ensure availability of three main elements:

- 1) atmospheres of the universal control;
- 2) monitoring systems behind accounts department and the finance;
- 3) methods of realization of test audits.

The most typical kinds of swindle from outside wage and salary earners:

⁷¹ *Accounting and Auditing Enforcement Release № 1585, June 27, 2002 <www.sec.gov>*

- larceny of a cash from cash desk;
- larceny of checks;
- cash use not as required;
- falsification of cash-books;
- falsification of the sums on bank accounts;
- a fake of checks;
- use of receipts in pension funds not as required;
- submission of the falsified invoices;
- falsification of way bills;
- overestimated invoice preparation;
- stock thefts;
- arrangement to clients or suppliers;
- use front suppliers;
- issue of fictitious bills;
- use of employees, the equipment or firm materials to suit the own ends;
- manipulations with credit cards;
- swindle with the insurance;
- not declared incomes;
- falsification of tax returns;
- fraud with an abacus from medical institutions;
- falsification of records in account books;
- reporting falsification about business trips;
- overestimate of costs;
- inclusion in the report on business trip of personal expenditure;
- unreturn the sums issued in advance;
- unapproved sale of property of firm;
- swindle with payment of wages;
- cashing in of dead checks;
- falsification of hours of overtime work;
- the wage of workers.

Further the most popular methods of falsifications of reporting are reviewed. As a rule, investors, potential partners and other external users of the reporting first of all pay attention to three basic indicators of the operation of the company, opened in the reporting, is the size of a gain, net profit and cumulative company assets. To meet expectations investors, management frequently deforms the data in the income and expenditure statement, balance or not completely opens them in notes on accounts. It will be dwelled upon the most wide-spread methods of falsification of the data of the financial reporting. Distortion of the information on the size of a gain and a company profit.

Accounts with front companies. The organisation can carry out with the counterpart (newly established or already existing front company) counter operations on purchase and sale. Thus the goods frequently or do not exist at all, or never moved for warehouse limits. As a result real flow of funds is accompanied by fictitious documents on moving of the goods. The similar scheme has been used by company Boston Scientific Corporation: contracts of lease of additional warehouses where the goods, ostensibly realized to buyers were transported consisted. After a while fictitious buyers returned the goods, receiving in exchange money. The goods resold to real buyers. Thus, the gain was reflected in that point of time when it was favorable.

Preschedule recognition of a gain. According to a principle of charge the gain and the costs connected with its reception, should admit the same accounting period. However on border of accounting periods of the company quite often infringe upon this principle: for example, the gain admits in December, and the costs connected with its reception, – in

January. It allows to overestimate margin of profit. So the known company on production of software Applix Incorporated, convicted of swindle as a result of recently finished investigation of Securities and exchange commission of the USA (SEC)⁷² operated.

Concealment of costs in book keeping. The wide circulation was received by schemes at which expenses incurred are not registated in book keeping. To carry out such operation, without being beyond active accounting standards, the companies aspire to reflect incomes in own book keeping, and a part of costs to make at the expense of the companies under control to them.

Capitalisation of costs. Quite often the companies resort to wrongful capitalisation of costs (carry them on cost of extranegotiable assets) which actually are connected with gain reception in an accounting period that as a result leads to profit overestimate. For example, percent on the loan proceeds involved not for purchase of permanent assets, and for closing of cash ruptures can be capitalised. Such method of swindle has been applied by company WorldCom to which as a result managed to overestimate profit almost on 4 bln. US dollars⁷³.

Sale with a condition. At the transaction with a condition the receipt of the goods admits, despite the fact that what the agreement contains essential uncertainty concerning transition of the property rights and reception of benefits. Sale of goods with the right of a buy-back during certain time can be an example of such bargain. On the economic essence the given bargains should be classified not as realisation, and as money loan on the security of the goods.

Fulfilment of period contracts. At fulfilment of period contracts (for example, on capital construction) the gain should admit during the long period of time. The international practice of book keeping (ISA 11 «the Account of contracts on building», GAAP «CON 5 Recognition and an estimation in the financial reporting of the companies») establish the USA that the gain recognition under long contracts is possible either on termination of the contract, or with use of a method of a stage-by-stage recognition of a gain. At a stage-by-stage recognition of a gain it is necessary to advance percent of complete amount of works that requires expert appraisals. Overestimating percent of work performeds, the companies thereby overestimate also a gain of a current accounting period. Company actions 3Net System Incorporated can be an example of use of such scheme of swindle. As it has been established

⁷² *Accounting and Auditing Enforcement Release № 2361*, January 4, 2006 <www.sec.gov>

⁷³ *Accounting and Auditing Enforcement Release № 1585*, June 27, 2002 <www.sec.gov>

by Securities and exchange commission of the USA, this company essentially overestimated a gain at the expense of distortion of percent of completeness of the project on software creation⁷⁴.

Sale of goods to intermediaries. The companies on production of tobacco, medical preparations and cosmetics often recognise a gain at the moment of shipment of the goods to intermediaries (resellers). It is supposed, as the companies-manufacturers sell the goods to intermediaries at a discount with term of payment after sale of goods. However if it will be impossible to realise the goods, ability of the debtor to reset the indebtedness can be called in question. Furthermore there is a high risk of return of goods by the intermediary because of inadequate quality. Thus, the gain admits the companies-manufacturers before the term provided by accounting standards. The similar policy of sales was conducted by the known company on production of contact lenses Baush and Lomb, Incorporated⁷⁵.

The companies can realize the goods of inadequate quality through firms-intermediaries on an overall cost. Thus the intermediary pays by agreement actual cost of rejected goods, other part of a debt receivable is written off in due course as unreal to collection. Thus the gain of a current year is overestimated and the profit of the subsequent accounting periods is underestimated.

Stocks. According to the international practice of the account material stocks are evaluated in the balance sheet on least of two sizes: acquisition amounts or at fair cost (the sum of means which can be received as a result of sale on a market overt). If the acquisition amount exceeds a sale net price the companies are obliged to carry a difference on costs of a flowing period.⁷⁶ Without having made it, the company has an opportunity to overestimate profit for an accounting period and balance currency.

A debt receivable. The basic method of distortion of a debt receivable – inclusion in its structure of the fictitious indebtedness and debts, unreal to collection. Concluding contracts on sale of goods with figureheads, the companies recognise a gain, however real moving of the goods and money resources does not occur. The fictitious debt receivable admits closer to an end of a financial period as reflexion of an outstanding debt receivable in the balance sheet during longer time can lead to necessity of writing off of receivables or reserve creation on

⁷⁴ *Accounting and Auditing Enforcement Release № 879*, February 6, 1997 <www.sec.gov>

⁷⁵ Comiskey E., Mulford C. *The Financial Numbers Game: Detecting Creative Accounting Practices* NJ: John Willey and Sons, 2002, 162p

⁷⁶ «IFRS stock accounting», *Financial director*, 2005, № 3, p. 35.

doubtful debts more often. To prevent possibility of detection of similar schemes and the rests of a debt receivable auditors, are used uncorrect mail addresses of the companies-debtors. Auditors, having received from such debtor acknowledgement of a balance of debt, can be misled. So, at the expense of manipulations with size of material stocks and company Symbol Technologies Incorporated receivables it was possible to overestimate a gain on 230 million US dollar, and before tax profit – on 530 million US dollar, for what it has been fined on 37 million dollars USA.⁷⁷

Fixed assets. One of the most simple ways of distortion of cost of extranegotiable assets – statement on the account of fictitious assets. Overestimate of value of assets leads to increase in currency of balance and an ownership capital. To overestimate cost of extranegotiable assets, the companies or consider assets documentary at their actual absence, or conclude contracts on capital lease for audit realisation, naturally, without opening the information that assets are leased and do not belong to the companies on the property right. As has shown one of investigations of Securities and exchange commission of the USA, company Qwest Communications International Incorporated considered on balance fictitious permanent assets, including the sums from their "sale" in structure of a gain from sales. As a result of Qwest Communications it was possible to overestimate a gain on 3,8 bln US dollars⁷⁸.

Schemes including the affiliated and dependent companies. The manipulation rules of consolidation of the financial reporting allows the companies to reach the most different purposes. At the expense of unreasonable increase in the price of the own shares, sold to affiliated company, it is possible to overestimate goodwill (which it is considered as a part of assets). For the purpose reflexions of higher profit in the consolidated reporting of the company can resort to schemes of "double sales»: at first the goods are sold on an overcharge of affiliated company which then sells its to end user. Thus, at the expense of decrease in volume of the profit, a share minority shareholders, the consolidated profit of group is overestimated. On each "dollar" of the profit got by a controlling company from affiliated, consolidated profit increases by size which can be calculated under the following formula:

$$G = (1 - r)x(1 - p)xP, \quad (4)$$

⁷⁷ *Accounting and Auditing Enforcement* Release No. 2190, February 17, 2005 <www.sec.gov>

⁷⁸ *Litigation Release № 18936*, October 21, 2004. <www.sec.gov>

where G - profit of group on operation;
 r - a tax rate on profit, %;
 p - an ownership ratio in affiliated company, %;
 P - size of profit of a controlling company from affiliated company sale of goods.

Fraud in notes to the financial reporting

For example, if not to open data on the granted warranties or other contingent liabilities, the facts of fraud of chiefs, shareholders and other users of the financial reporting can be misled. By the way, in the latter case, being afraid for reputation of the company, the board of directors quite often prefers to dismiss the guilty chief, instead of to publish the facts of the fraud made by him.

Deals with the connected parties. Deals with the connected parties are an integral part of business of almost any modern company, however frequently their conditions differ from market.⁷⁹ If the gain from operations with the connected parties constitutes the essential from company total receipts the probability of is great that the damage is caused to interests of shareholders.

Disclosing of the information on an accounting policy. Changes in an accounting policy are capable to render both insignificant, and enormous influence on financial reporting indicators. For example, revision of an applied method of amortisation concerning group of assets, most likely, will not lead to major modification of structure of the balance sheet. However as a result of change of a method of valuation of permanent assets or stocks it can be changed considerably both balance currency, and a company profit.

In the appendix to the financial reporting of pharmaceutical company Elan Corporation, PLC, throughout a number of years reflecting in the reporting a record gain, it was informed that the company intends to earn 5 billions US dollar in 2005. In conclusions of Securities and exchange commission of the USA it has been indicated formation as a result of such applications of unreasonable expectations of investors: Opening the information on an accounting policy, Elan Corporation has not explained, at the expense of what is going to receive such results. Besides, the information on an accounting policy concerning a gain from

⁷⁹ *Related parties in IFRS reportints.* Financial director, 2005, № 11, p. 41.

sales though the royalty and commissions have been included in its structure with affiliated companies has not been opened.⁸⁰

How to elicit the fraud facts in the financial reporting?

Despite variety of the data distortion schemes in the financial reporting, all of them are anyhow aimed at overestimate of a gain, profit and balance currency. Therefore even if to use only the popular information, it is possible to reveal fraud signs in the reporting and to constitute own opinion on reliability of the data presented in it Let's take a look to the approaches, allowing to reveal fraud in the financial reporting. In the given work all signs of fraud are not considered. Only the financial indicators analysis as the instrument of revealing of frauds and possible distortions. To a fraud symptom probably to carry strange changes of financial indexations:

- increase in incomes at reduction of is financially-industrial stocks;
- increase in incomes at reduction of amount of transferred money;
- increase in incomes at turn-over reduction on cash desk;
- increase in stocks at accounts payable reduction;
- increase in number of sales at price increase per unit of output; o Turn-over increase at reduction of the rests;
- increase in stocks at reduction of expenses by service of warehouses.

If in the reporting "symptoms" of possible distortion of the information are found out, it is necessary to calculate fraud indicators.

The Map of standard deviations of financial indicators⁸¹

Days Sales in Receivables Index (DSRI):

$$\text{Days Sales in Receivables Index} = \frac{\text{Receivables}}{\text{Sales}} \bigg/ \frac{\text{Receivables}_{t-1}}{\text{Sales}_{t-1}}, \quad (5)$$

„DSRI is the ratio of days sales in receivable in the first year in which earnings manipulation is uncovered (year t) to the corresponding measure in year t-1. This variable ganges whether receivables and revenues are in or out-of-balance in two consecutive years. A large increase in days sales in receivables could be the result of a change in credit policy to spur sales in the face of increased competition, but disproportionate increases in receivables relative to sales may also be suggestive of revenue inflation. It is expected a large increase in

⁸⁰ *Accounting and Auditing Enforcement Release № 2181*, February 8, 2005 <www.sec.gov>

⁸¹ *The Detection of Earnings Manipulation*. Messod D. Beneish. Social Science Research Network. <<http://www.ssrn.com/>>

days sales in receivables to be associated with a higher likelihood that revenues and earnings are overstated“.

Gross Margin Index (GMI):

$$\text{Gross Margin Index} = \left(\frac{\text{Sales}_{t-1} - \text{Costs of Goods Sold}_{t-1}}{\text{Sales}_{t-1}} \right) \bigg/ \left(\frac{\text{Sales}_t - \text{Costs of Goods Sold}_t}{\text{Sales}_t} \right), \quad (6)$$

„GMI is ratio of the gross margin in year t-1 to the gross margin in year t. When GMI is greater than 1, it indicates that gross margins have deteriorated. Lev and Thiagarajan (1993) suggest that gross margin deterioration is a negative signal about firms' prospects. If firms with poorer prospects are more likely to engage in earnings manipulation, I expect a positive relation between GMI and the probability of earnings manipulation“⁸²

Asset Quality Index (AQI):

$$\text{AssetQualityIndex} = \left(1 - \frac{\text{Current Assets}_t + \text{PPE}_t}{\text{Total Assets}_t} \right) \bigg/ \left(1 - \frac{\text{Current Assets}_{t-1} + \text{PPE}_{t-1}}{\text{Total Assets}_{t-1}} \right) \quad (7)$$

„Asset quality in a given year is the ratio of non-current assets other than property plant and equipment (PPE) to total assets and measures the proportion of total assets for which future benefits are potentially less certain. AQI is the ratio of asset quality in year t, relative to asset quality in year t-1. AQI is an aggregate measure of the change in the asset realization risk analysis suggested by Siegel (1991). If AQI is greater than 1 it indicates that the firm has potentially increased its involvement in cost deferral. I thus expect a positive relation between AQI and the probability of earnings manipulation. An increase in asset realization risk indicates an increased propensity to capitalize and thus defer cista“.

Sales Growth Index (SGI):

$$\text{Sales Growth Index} = \text{Sales}_t / \text{Sales}_{t-1} \quad (8)$$

„SGI is the ratio of sales in year t to sales in year t-1. Growth does not imply manipulation, but growth firms are viewed by professionals as more likely to commit financial statement fraud because their financial position and capital needs put pressure on managers to achieve earnings targets (National Commission on Fraudulent Financial Reporting (1987), National Association of Certified Fraud Examiners (1993)). In addition,

⁸² *The Detection of Earnings Manipulation.* Messod D. Beneish. Social Science Research Network. <<http://www.ssrn.com/>>

concerns about controls and reporting tend to lag behind operations in periods of high growth (National Commission on Fraudulent Financial Reporting (1987), Loebecke et al. (1989)). If growth firms face large stock prices losses at the first indication of a slowdown, they may have greater incentives to manipulate earnings. To this effect, Fridson (1993, pp. 7-8)⁸³ states: "Almost invariably, companies try to dispel the impression that their growth is decelerating, since that perception can be so costly to them." I thus expect a positive relation between SGI and the probability of earnings manipulation“.

Depreciation Index (DEPI):

$$\text{Depreciation Index} = \left(\frac{\text{Depreciation}_{t-1}}{\text{Depreciation}_{t-1} + \text{PPE}_{t-1}} \right) \bigg/ \left(\frac{\text{Depreciation}_t}{\text{Depreciation}_t + \text{PPE}_t} \right) \quad (9)$$

„DEPI is the ratio of the rate of depreciation in year t-1 vs the corresponding rate in year t. The depreciation rate in a given year equals is equal to depreciation/(depreciation+net PPE). A DEPI greater than 1 it indicates that the rate at which assets are depreciated has slowed down--raising the possibility that the firm has revised upwards the estimates of assets useful lives or adopted a new method that is income increasing.10 I thus expect a positive relation between DEPI and the probability of manipulation“.

6.Sales General and Administrative Expenses Index (SGAI):

$$\text{SVG Index} = \left(\frac{\text{SGV Expense}_t}{\text{Sales}_t} \right) \bigg/ \left(\frac{\text{SGA Expense}_{t-1}}{\text{Sales}_{t-1}} \right), \quad (10)$$

„SGAI is calculated as the ratio of SGA to sales in year t relative to the corresponding measure in year t-1. The variable is used following Lev and Thiagarajan’s (1993) suggestion that analysts would interpret a disproportionate increase in sales as a negative signal about firms future prospects. I expect a positive relation between SGAI and the probability of manipulation“.

7. Leverage Index (LVGI):

$$\text{Leverage Index} = \left(\frac{\text{LTD}_t + \text{Current Liabilities}_t}{\text{Total Assets}_t} \right) \bigg/ \left(\frac{\text{LTD}_{t-1} + \text{Current Liabilities}_{t-1}}{\text{Total Assets}_{t-1}} \right), \quad (11)$$

⁸³ *The Detection of Earnings Manipulation*. Messod D. Beneish. Social Science Research Network. <<http://www.ssrn.com/>>

„LVGI is the ratio of total debt to total assets in year t relative to the corresponding ratio in year t-1. A LVGI greater than 1 indicates an increase in leverage. The variable is included to capture debt covenants incentives for earnings manipulation. Assuming that leverage follows a random walk, LVGI implicitly measures the leverage forecast error. I use the change in leverage in the firms' capital structure given evidence in Beneish and Press (1993) that such changes are associated with the stock market effect of default.“⁸⁴

To use a card of standard deviations, we need the enterprise reporting for some periods (at least for two years, and also probably to use the reporting comparable to the sizes of the enterprise, active in the same branch.

On each indicator the expert is offered to mark points:

0 – if the indicator does not testify to possible distortion;

1 – if the indicator testifies to possible distortion, but to the expert the facts which have led to change of the indicator and the given facts are known and are mentioned in the reporting or their nature has no character of an error, manipulation or fraud;

2 – if the indicator testifies to possible distortion and to the expert the facts which have led to change of the indicator are not known.

Thus, using various instruments of the financial analysis it is possible to generate certain judgement about the level of errors, mistakes and distortions in the financial reporting and to judge its reliability.

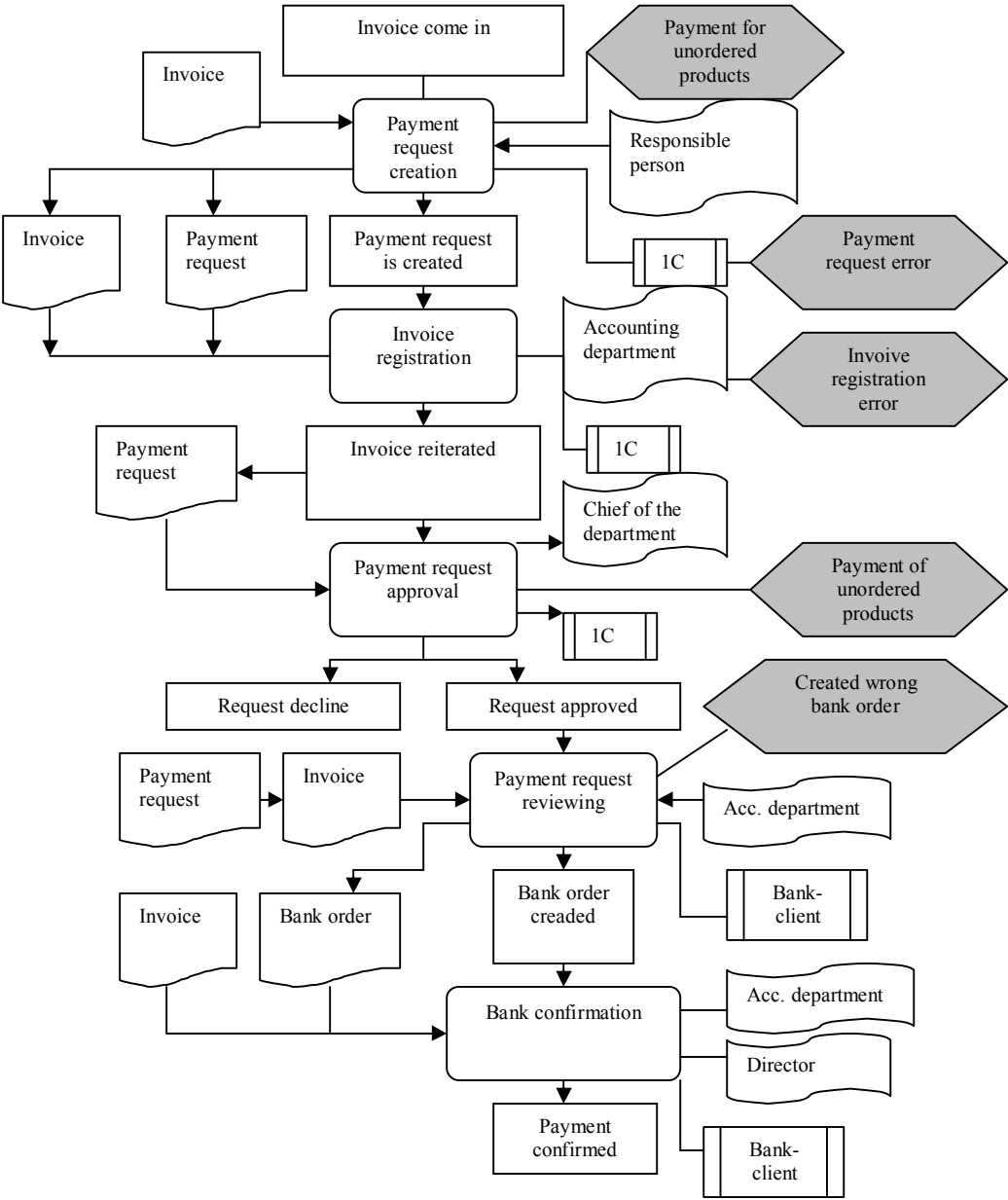
3.3.2 Risks of distortions

Also it is possible to judge reliability of the financial reporting having analyzed risks of distortions and a control tools. In the previous part the model of Benesh which according to experts is capable to reveal to 50 % of distortions has been presented and modified. For reception of more complete picture about the information represented in the financial reporting how many is truthful and that the given information has no essential errors and distortions it is offered to carry out the analysis and an estimation of the process risks. Further the process «Preparation of documents on merchandise payment» analysis is made

⁸⁴ *The Detection of Earnings Manipulation*. Messod D. Beneish. Social Science Research Network. <<http://www.ssrn.com/>>

The given process defines work with documents on payment of products or services. It is conditionally defined that there is no any analysis of accounts, influencing the financial reporting, and it is accepted that in the given process work is led only with an essential accounts.

Stage 1. The process description. The model of the given process is presented in picture 13.



Picture 13. Process scheme

At the given stage all process with allowance for document circulation are described, a personal liability assigned according to duty regulations and document registrations in computer registration system.

Then the model is described and «the process Description» is tabulated.

Table 9. The process description «Preparation of documents on merchandise payment»

The name of a process step	Executor	Comments
Payment request creation	Responsible employee of the department	At receipt of the invoice from the counterpart on , the responsible of division enters the request for payment of the given invoice into the system
Invoice registration	Accounting department	Responsible employee of accounting department registers invoice
Payment request approval	Chief of a department	The responsible chief of department comes into system and considers all request for payment within the limits of division. The chief of department makes the decision on payment or decline request for payment
Bank order creation	Accounting department	The responsible of accounting department will be authorized in system Bank-client, opens the form of creation of bank order and on the basis of the basic document (the account, the invoice) and the data which were entered by the Responsible of division into system, creates the payment order
Paayment confirmation	Director, chief accountant	After the Responsible of Accounts department has created payment orders in electronic form in system Bank-client, the Chief accountant and the General director, sign a digital signature payment orders in system Bank-client and sends them in Bank

Stage 2. Identification of risks influencing reliability of the financial reporting. At the given stage the model of process with risks is under construction. It is possible to identify risks using process model «Merchandise payment» presented in picture 13. All revealed risks on model are designated by grey figures. The characteristic of risks is presented in table 10.

Table 10. Process risks

The name of a process step	Purpose	Risk	Risk description
Payment request creation	Assets safety	Payment for unordered products	There is a possibility of that the employee will create (probably, together with the chief) the request for payment of the goods for the personal purposes
Payment request creation	Errors avoidance	Payment request error, Invoice registration error	There is a possibility of that the employee will commit an arithmetic error at invoice registration on which basis the payment order will be then created
Bank order creation	Assets safety	Payment for unordered products	There is a possibility of that the employee will add the sum of electronic payment on payment of the goods for the personal purposes

Stage 3. An estimation of the importance of risks. At the given stage it is allocated the most significant risks. Risks can be evaluated by a technique which consists in development of estimations of two most often used parameters of each of risks – influences (impact) and probabilities. Result of product of these two sizes, the expected size (exposure) which is the uniform metrics of risk. The example of an estimation of risks is resulted in Table 11.

Table 11. Process risk relevance

Process name	Problems	Risk	Deliberate	Probability	Influence	Expected value
Invoice registration and payment request creation	Information distortion	Registration error	no	small	Significant	Average risk level
Payment request creation	Assets safety	Payment of unordered products	yes	average	Significant	High risk level

It is putted "Yes" in columns "Deliberate" if the risk deliberate and "is not present" – if the risk is caused by casual circumstances or errors. In a column "Probability" significances can be written down: "small", "average" or "high". In a column "Influence" significances can be written down: "small", "average" or "high". In a column «Expected size» following significances can be written down: "Insignificant" or "Significant".

For example, at use of a scale for probability and the influence, consisting of three significances, possible significances of the expected size can be presented a matrix presented above.

According to picture 13 of the given example it is possible to recommend the following control procedure: as soon as the invoice is entered into system, it becomes accessible to viewing. All chiefs of structural divisions should check demands up to the general director. Thus the demand passes to the following level of the coordination, only if it is adjusted at all previous levels. The given control can be provided for all demands or for demands exceeding the determinate sum.

Thus, having evaluated all private risks on essential operations it is necessary to experts to give an estimation of the general risk of the financial accounting.

3.3.3 Information filters.

One of factors influencing on the financial reporting quality and the perception of the financial information are information filters. It is clear that managerial decisions quality depends on the decision-maker's qualification as well as the information quality which is available for the decision-making. Accountants are responsible for granting of the financial information which is necessary for acceptance of administrative decisions, concerning position and activity of the enterprise in the market. The administrative decision of the top manager or the proprietor on with positive, or negative consequences essentially surpasses the importance of the decisions accepted by the low or middle management.

Certainly, maintenance on an accessory as much as possible qualitative information of all users of the financial reporting would be an ideal variant, but the specific of national tax, audit and accounting legislation, distinction with European economic activity experience, business making style, features of shareholders capital, top management education and structure (top manager is an owner, state control), and the accounts departments specific which are still being in a stage of formation at Russian enterprises caused the impossibility of direct transformation of foreign experience in the field of the financial reporting quality.

In this connection it looks actual to consider factors limiting or deforming the financial information arriving to the top management of the enterprise. The given factors or situations will be named information filters. As it is known from the signalling theory, the filter is a device definitely limiting (reformative) a stream proceeding through it. Thus, the information filter limits a stream of the information proceeding through it. The understanding of the information streams restriction nature at the enterprise allows to compensate in certain degree their negative influence on decision-making process. So, the research purpose is to determine and to list the information filters, which are quite typical for the Russian enterprises, without dependence from their size and a pattern of ownership, limiting quality of the financial information at its receipt to users.

Discussion

The given list has been made as a result of interrogation and conversations with heads of different levels of management of the enterprises of all patterns of ownership. The research is made thanks to Internal Grant Agency of Business and Management faculty Brno University of Technology N AD 179001M2

1. *The filter "ORGANIZATIONAL IMPERFECTION"* is shown in absence at the enterprise of the uniform centre of processing and the analysis of the financial information arriving to the director from a number of divisions (various commercial and economic services), presented in various execution (format). It can be the report both the oral message and the data shown in the tables.

Thus the problem of reduction and the comparative analysis of data entirely lays down on the boss, which is overloaded with administrative problems. It often means, that by the most valuable analytical information, is lost.

Comparison of the financial information from divisions on reliability is not also organized, that reduces quality of a management information supply.

Negative influence of the given filter can be reduced by system engineering of the indicative information for the head. The bookkeepers reduce the diverse information intended for the director in a uniform format, containing the limited number of the indicators representing dynamics most of the general indicators of work of the enterprise and regularly enter it into the computer of the chief in the form of schedules, diagrams and etc. in a uniform format.

2. *The filter "LOW qualification-1"* is shown in absence at the enterprises of good experts in the field of representation of the financial information, so quality of carrying out of these works as a rule is low.

The effective, but the expensive method of struggle against this filter is the invitation of outside experts. In conditions of a total lack of money it is necessary to hope for fast "growing" of the accounting at the enterprises.

3. *The filter "LOW qualification-2"* is shown in inability of the top management to work with the information. Many bosses do not like to admit misunderstanding or ignorance something, being afraid to drop the authority before subordinates and therefore tear away obscure information.

Accountants, considering this situation should present, first of all, the material as much as possible by simple language, and, secondly, to try to find out, what form of representation of the information is most comprehensible to the given head and gradually to "tame" the head to consumption of the information, for example, by giving of the important information by other way.

4. *The filter "METHOD of PROCESSING of the INFORMATION"* is shown in introduction of limiting conditions, that are normal for mathematical method applied to processing of the information. The important information can be lost because of incorrectly chosen method of processing.

If the method of processing of the data received during researches is chosen correctly and limiting condition characteristic for methods are put correctly therefore firm representation about an environment will correspond to the validity.

If the data processing method is chosen incorrectly firm representation about an environment will be deformed and therefore its strategic behaviour will be inadequately to market realities.

In order to avoid it, for processing of data it is possible to recommend a method of expert estimations which is more soft even for the most valuable intuitive information.

5. *The filter "SUCCESSFUL INSTALLATIONS"* is shown in aspiration of managers to use standard methods of the decision of the arising problems, already fulfilled earlier on similar problems (experience of the manager).

Any manager in his activity, develops sooner or later model of successful actions in the conditions of a constant set of factors and dependences between them in the given environment. The skilled manager with use of such a model during receiving difficult information, is capable to analyse it and choose quickly an optimum line of conduct.

But with increase of uncertainty and variability of an environment the same model, that based only on experience of the past, ceases to work and becomes a brake interfering reorganization of consciousness of the manager.

The head has a temptation to tear away inconvenient, not connected with last experience, information. Especially often it occurs to the financial information made according to new standards for example IFRS which as well as the idea of ISA has not got accustomed at many Russian enterprises.

Degree of this filter can be measured and definitely characterises "ageing" of the administrative personnel at the enterprise.

6. *The filter "REAL POWER"* is shown in aversion of the information by the managers having the real power at the enterprise if this information threatens their position.

At any enterprise, without dependence from its sizes and a pattern of ownership there are groups of people or divisions which combat among themselves for the power at the enterprise which can be expressed in the control over financial streams, or in prevailing influence on the head of company, that finally allows the won group to define a policy of the enterprise.

If the thinking of "winners" is based on experience of the past and mismatches a modern situation, the enterprise inevitably loses the positions in the market and enters into a crisis zone because the basic resources of the enterprise are distributed in favour of in the leading group, is frequent to the detriment of interests of firm as a whole.

For many Russian firms redistribution of the real power between industrial, having the power and commercial departments, gaining in strength now. Therefore the financial information testifying to the growing importance of a commercial component of management is turning away by "production workers" actively.

Effective instrument for reduction of influence of this filter is to increase economic and financial qualification of heads of all levels at the enterprise.

7. *The filter "RESISTANCE of a middle MANAGEMENT"* is shown in tearing away by middle management of operating influences from the top management as middle management sometimes does not understand all essence of an event and perceives it as threat to their position.

Resistance of middle management is shown in "pushing out" of "linear" problems to top management level (questions of supply, manufacture and so on).

This effect is a consequence of insufficient knowledge of middle management about motives of decision-making by the top management, and also that the middle manager as a rule has no necessary information for decision-making of optimum decisions within the limits of the competence.

Therefore it is important, that the chief besides delivery of instructions not only "share" the information with subordinates, but also in every possible way supported regular increase of financial qualification of management at the enterprise.

Thereby the effect of "resistance" by middle management decreases at realization of actions.

Thus, knowledge of the factors that influence data quality in Accounting will assist organizations to improve their accounting information systems' data quality. While many Accounting Information System studies have looked at internal control and audit, Data Quality (DQ) studies have focused on the measurement of DQ outcomes. It appears that there have been very few attempts to identify the Critical Success Factors for data quality in AIS and to measure the financial reporting quality. Thus, there is a need for research to identify the factors that affect financial reporting. Quality information is critical to organizations' success in today's highly competitive environment. Accounting information require high quality data. However, empirical evidence suggests that data quality is problematic in accounting sphere. Therefore, knowledge of factors influencing on the financial reporting quality, factor's evaluation that are important in ensuring data quality in accounting information systems is desirable.

4 FINANCIAL REPORTING QUALITY CONTROL APROBATION

4.1 Characteristics of the enterprise

The developed technique of quality assurance of the financial reporting has been approved on the open joint-stock "ZMT" (further – “ZMT”).

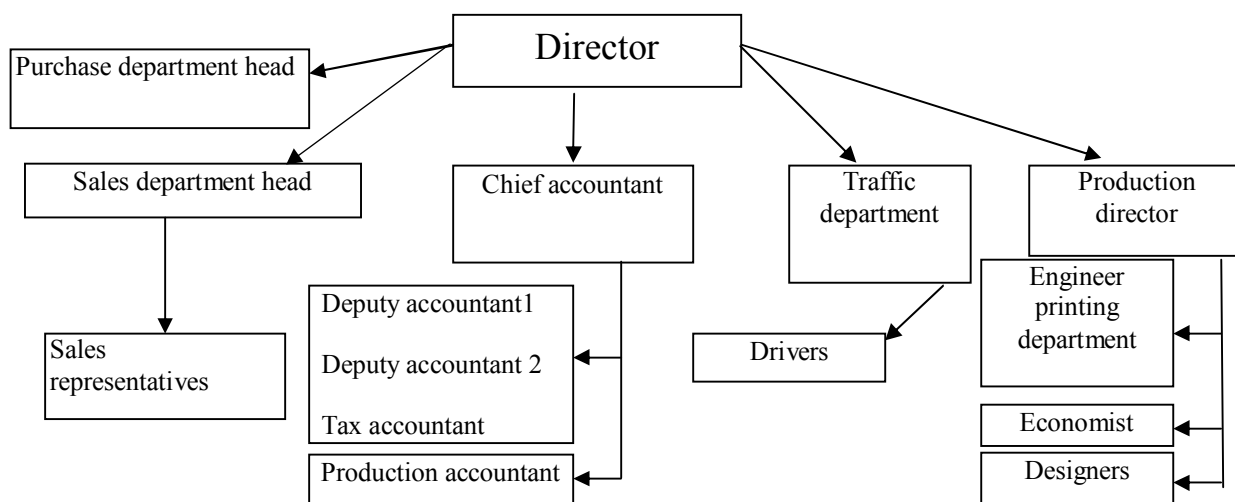
The complete company name - open joint-stock company «Zavod Medecinskoj Techniki». The reduced company name – OAO "ZMT" (further – Company or “ZMT”).

The “ZMT” is created according to the Federal statute «About open joint-stock companies»⁸⁵. The company activity is guided by the Civil code, the Federal statute, and also founding documents – the Bylaw and the Articles of incorporation. Company is situated in Izhevsk city, in the street M .Gorkogo, 90, Udmurt republic, Russia.

ZMT is the industrial enterprise, working in the medicine equipment more than 13 years. The company has been created in 1995. Also company is entered into the affiliate group of corporations «Aksion». Now “ZMT” is the independent enterprise in the concern and also is the large tax bearer in budgets of all levels.

“ZMT” seller's market covers the whole part of Russia. Development of more remote regions is not represented effective. Despite it, after taking part in the international exhibition the external economic contracts on delivery of equipment with Mongolia, China, Belarus and Ukraine have been signed. The company independently advances structure of controls. In administrative personnel, according to the picture 14, enters:

⁸⁵ The Federal statute from February *About open joint-stock companies*. 8th, 1998 N 14-FZ (with amendment and adds From July, 11th, on December, 31st, 1998, on March, 21st, 2002, on December, 29th, 2004)



Picture 14. - Administrative personnel Structure

In 2007 the following priority direction of activity of Company - production of equipment and its delivery by state agreement for the first help ambulance under the national project "Health" has allowed to ensure growth of production volumes⁸⁶.

In 2007 the Company has run in serial issue of the modern devices, to the out-of-date models which have come on replacement (with application of modern technologies - superficial installation), their application has allowed to leave on qualitatively new level of manufactured items.

The Company owner's equity stock constitutes 5 701 183 (Five millions seven hundred one thousand hundred eighty three) rouble. The authorised capital stock is constituted of a nominal value of shares of the Company acquired by shareholders (the placed shares), namely, from 5 701 183 (Five millions seven hundred one thousand hundred eighty three) pieces of ordinary inscribed shares by a nominal value 1 rouble.

In Company there is a reserve fund at a rate of 15 percent from the Company owner's equity. The size of annual deductions in the Company reserve fund constitutes 5 percent from Company net profit. The Company reserve fund is intended for a cover of its losses, and also

⁸⁶ *Finansovaya otchetnost' OAO «ZMT»* www. <Axionet.ru>

for paying to off bonds of Company and redemption of shares of Company in case of absence of other means.⁸⁷

It is necessary to notice once more that the Company is associated with company «the Izhevsk motor-factory" Aksion-holding ", mutual relations of the basic and affiliated Companies are under construction on the basis of the concluded agreement for mutual relations.

Also it is necessary to notice that the control over financial and economic activity of Company is carried out by the Auditing committee. The order of activity of the Auditing committee is defined by the Federal statute «On joint-stock companies», the present Charter, and also approved general meeting of shareholders by Position about the Auditing committee.

The Company auditing committee is selected as a part of 8 persons on general meeting of shareholders for the term up to following annual general meeting of shareholders. Members of the Auditing committee can be re-elected unlimited number of times. The member of the Auditing committee has the right to leave under the initiative its structure at any time, having informed the Company in writing form. A member of the Auditing committee can be both the shareholder of Company, and any person offered by the shareholder. Members of the Auditing committee of Company cannot be simultaneously councillors of directors of Company, and also take other posts in Company controls. Check (auditing) of financial and economic activity of Company is carried out following the results of Company activity for a year, and also at any time at the initiative of the Company Auditing committee, to the resolution of the general meeting of shareholders, Board of directors of Company or on request of the shareholder (shareholders) of the Company possessing in aggregate not less than 10 percent of voting shares of Company⁸⁸.

The Company auditing committee has the right:

- To demand from the persons taking posts in controls of Company, discovery of documents about financial and economic activity of Company;
- To demand convocation of extraordinary general meeting of shareholders in an order provided by article 55 of the Federal statute «On joint-stock companies» and the Company Charter.

⁸⁷ *Ustav OAO ZMT Postanovlenie Glavy administracii Oktyabr'skogo raiona g. Izheska. 20.071995. reg. № 782/2*

⁸⁸ *Ustav OAO ZMT Postanovlenie Glavy administracii Oktyabr'skogo raiona g. Izheska. 20.071995. reg. № 782/2*

- To demand a convening of meeting of Board of directors. The chairman of board of directors has not the right to refuse to the Auditing committee a convening of meeting of Board of directors on its request.

Following the results of check of financial and economic activity of Company the Auditing committee constitutes the conclusion in which should contain:

- Acknowledgement of reliability of the data containing in reports, and other financial instruments of Company;

- The information on the facts of infringement established by elements of law of the Russian Federation of an order of accounting and financial reporting submission, and also elements of law of the Russian Federation at realisation of financial and economic activity.

According to Position about disclosing of the information by emitters of the issuing securities, approved by Order FSFR of Russia №06-117/pz-n from 10.10.2006⁸⁹, open joint-stock companies, and also the closed joint-stock companies which have carried out public placing bonds or other securities, grant the information in the Internet. The given request has been executed by Company and the required information has been placed on an official web-site.⁹⁰

4.2 Organization of quality control.

The technique of quality control of the financial reporting imposes certain requests to the experts who are conducting quality evaluation of the financial reporting. Observance of a principle of discretion, a pedantry and an estimation of each business process from the point of view of controllability and predictability, instead of from the point of view of absolute result, knowledge of accounting and experience in sphere of the finance – discriminating qualities of experts of quality control of the financial reporting and as a whole IC and audit.

With allowance of above mentioned restrictions the commission of experts was organized also so that in its structure there were representatives of all user groups of the financial reporting of open-joint stock company "ZMT".

The structure of a commission of experts included the physical persons taking following positions:

- The deputy of the general director on economy and the finance - the representative of the shareholder (legal person), a member of a revision committee of the "ZMT";
- The expert of a department of crediting “Foreign Trade Bank 24”;
- The deputy chief accountant of "ZMT";
- The chief of the in-office tax control department Federal Tax Service of Udmurt republic N9.

⁸⁹ Prikaz Federal'noi sluzhby po finansovym. 10.10. 2006. №06-117/pz-n *Ob utverzhdenii Polozheniya o raskrytii informacii emitentami emissionnyh cennyh bumag.* // Byulleten' normativnyh aktov federal'nyh organov ispolnitel'noi vlasti. 2007. № 4.

⁹⁰ *Finansovaya otchetnost' OAO «ZMT»* <www. Axionet.ru>

For the quality evaluation according to stages of the technique of quality control of the financial reporting the commission have studied the following documents:

- 1) The articles of association;
- 2) The financial reporting for the last 3 years, including audit reports and other reports;
- 3) Department of the internal control audit statutes;
- 4) An order of appointment of external auditors;
- 5) An order of realisation of the plan of checks by department of the internal control (audit);
- 6) Board of directors statutes;
- 7) General director statutes;
- 8) Auditing committee statutes;
- 9) Curriculum vitae about chiefs and the basic employees of accounting department;
- 10) An accounting policy and the taxation policy;
- 11) Positions, orders and the other regulating documents advancing an order of preparation managerial and audited financial reporting;
- 12) Protocols of a council meeting of directors for the last 12 months;
- 13) Reports of the internal control (audit) department;
- 14) The code of corporate culture;
- 15) Reports of auditing committees;
- 16) Remarks of external auditors;
- 17) The document circulation schedule;
- 18) The agreement of mutual relations with parent organization, etc.

On the basis of the above-stated documents preliminary submission about efficiency of existing monitoring systems, motivation and professional qualities of employees, and also about possible internal and external conflicts has been constituted.

Stage 1. Revealing of all factors influencing quality of the financial reporting. The commission of experts using the "brain storm" method has generated the list of all internal and external factors influencing quality of the financial reporting of an enterprise. At formation of the list experts were guided by the factors which influence can be directed on separate qualitative characteristics, and also on the reporting as a whole. Results are presented in table 12.

Table 12. The list of the revealed external and internal factors

External factors	
Accounting legislation	State policy in the industrial branch.
Types, scale and fraction of the market	The health of economy.
Internal factors	
Experience and qualification of accountants.	Internal conflicts of interests.
Chosen policy and methods of accounting .	Understanding of quality reporting.
Company purposes.	Organizational culture.
Contractual policy.	Relationship of the middle management to the quality reporting.

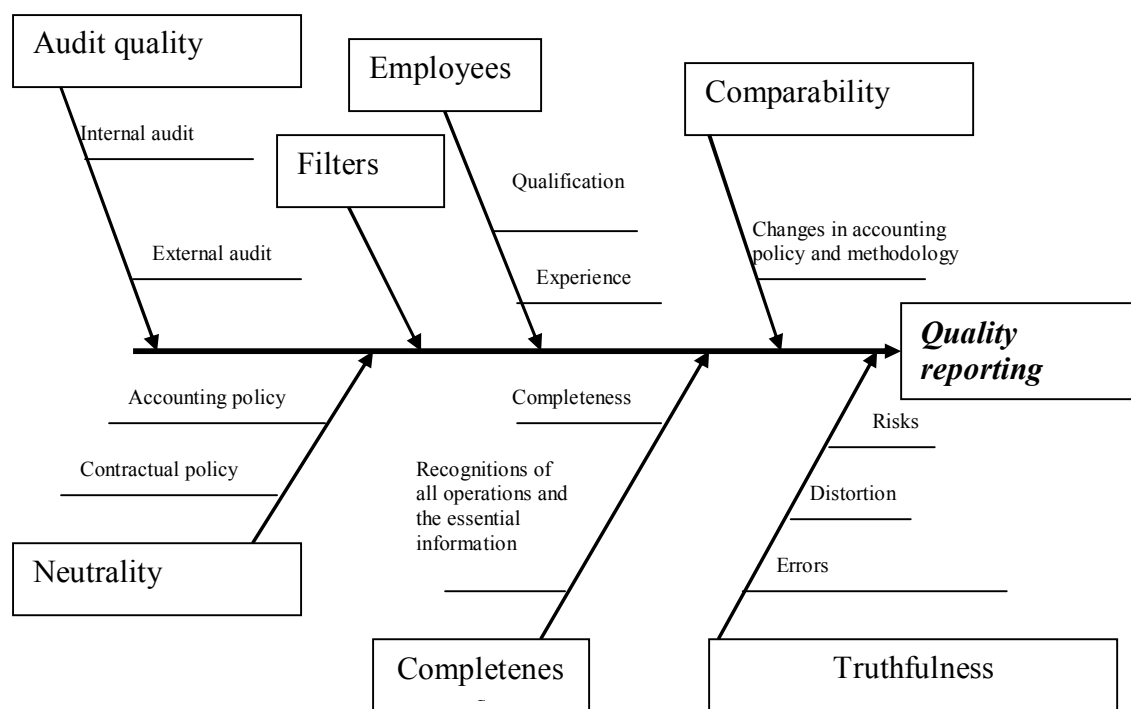
Risk-management level.	Organizational structure.
Internal audit quality.	International relationships of the company.
Team-work.	Access information policy .
Employee relationships.	External audit policy.
Completeness of operations registrations	Constant quality reporting improval.
The relation of the top management to financial reporting quality assurance.	Internal control efficiency
Internal communications	IT level.
Human resources.	Internal education and trainings
Personal responsibility.	

Stage 2. Allocation of essential factors. At the given stage the experts who are carrying out the control, have analysed all external and internal factors and have chosen the most essential, ranked and structured them on influence on separate qualitative characteristics and as a whole on quality of the reporting. The factors classified on levels are resulted in table 13.

Table 13. The factors influencing quality of the financial reporting are essential

First level factors	Second level factors
Neutrality of accounting principals and contractual relationships	Contractual policy
	Accounting policy
Audit quality	Quality of external audit
	Quality of internal audit
Accounting employees	Qualification
	Experiace
Comparability	Accounting policy changes
	Accounting methods changing
Truthfulness and absence of distortions and errors	Risks in accounting process.
	Possibility of distortions
	Errors in reporting
Information filters	
Completeness	Recognitions of all operations and the essential information

Stage 3. Construction of a cause and effect relationship. Experts had been constructed a cause and effect relationship diagramme presenting interrelations and influence of factors on quality of the reporting. The hierarchy of factors allocated on the second stage is presented in picture 15.



Picture 15. Hierarchy of quality influencing factors

Stage 4. An estimation of minor factors.

The factor «Staff Qualification». It was offered to experts to conduct a factor estimation « Staff Qualification», based on availability of education and professional courses. Having carried out the analysis of professional associations and their courses on the Internet, it has been advanced expedient, among various professional certifications and attestations, to allocate training programs recognized by all organizations. However level of professionalism of the accountant are confirmed only with some of them (rates and certificates for auditors in this case are not considered), classification presented in table 14 therefore has been conducted:

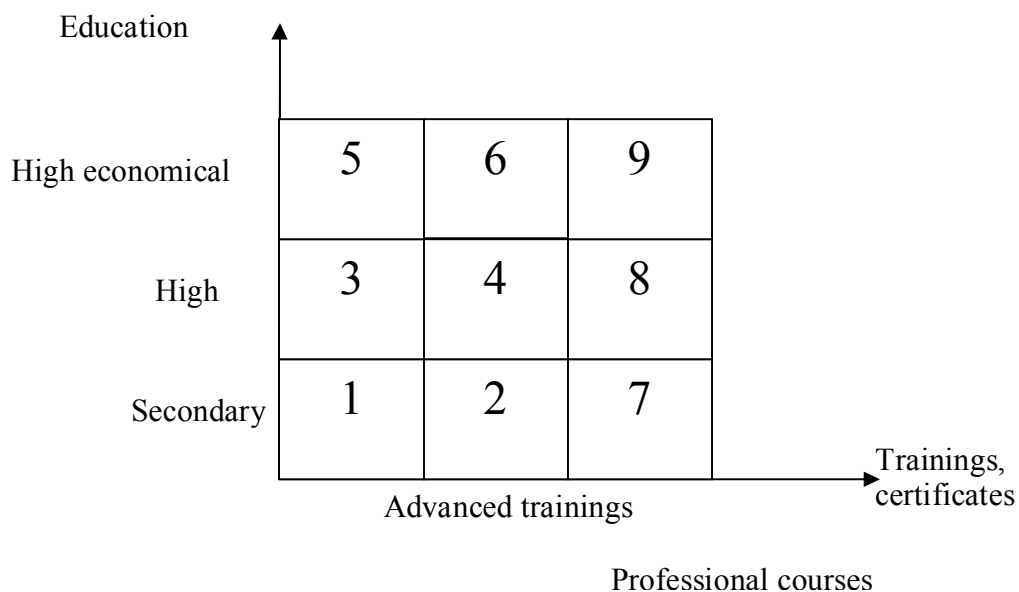
Table 14. The certificates confirming professional level of the accountant

Typ	For what	Knowledge, skills
Professional accountant attestation.	The owner is the certified professional accountant. It is a highest level qualification in accounting sphere in Russia. Was trained 240 or 500 hours and has successfully passed examination.	The professional accountant has an extensive knowledge in area: - Russian accounting and reporting, audit bases; - The taxation; - Financial management; - Management accounting; - Economic activities legal regulation. Has practical skills: - Reporting, budget planning and budgeting; - Flow control of financial resources and regulation of financial relations, workings out of financial strategy of the organisation;

		<ul style="list-style-type: none"> - Realisation of complex economic analysis of financial and economic activity, the analysis of the financial reporting and preparation on its basis of conclusions and bid evaluations on remedial action and revealing of internal reserves - problem economic situations decisions-making support.
The certificate on training of professional accountants.	The certificate confirms that the accountant was trained under the program (240 or 500 hours). The promotion examination is not provided.	<p>Is able to supervise:</p> <ul style="list-style-type: none"> - Observance of the legislation of the Russian Federation at realisation of economic operations and their economic feasibility; - Availability and movement of property and settlement of commitment; - Rational material use, labour and financial resources; - Observance of regular, financial and cash discipline, - Financial plan and budget creation.
The certificate on courses of improvement of qualification.	The certificate confirms that the professional accountant has passed courses of qualification improvement (the quantity of hours is underlined in the document). The promotion examination is not provided.	<p>Knows changes and innovations in the field of book keeping, the taxation and economic activities, legal regulation. Knows an item of official organs and arbitration practice.</p> <p>Has practical skills:</p> <ul style="list-style-type: none"> - Permissions of disputable economic situations; - Applications of new accounting methods; - Automation of registration-analytical works. <p>Professional accountants are obliged to increase constantly the qualifications (not less then 40h a year).</p>
The member ticket of chamber of tax advisers. *can to be the qualifying certificate.	The owner is the certified tax adviser. It is a qualification of the highest level in taxation sphere. Was trained under the program (380 or 580 hours) and has successfully passed examination.	<p>The accountant knows:</p> <ul style="list-style-type: none"> - Accounting; - The taxation; - Legislation. <p>Is able to apply, interpret, analyze the tax legislation, to do forecasts and to evaluate risks.</p> <p>Has skill of consultation concerning book keeping, reporting, tax control, economic analysis and the taxation legal and physical persons.</p> <p>The tax adviser is obliged to increase the qualification constantly.</p>
CIPA (Certified International Professional Accountant).	The owner is the certificated international professional accountant is a highest level of qualification in sphere of financial and management accounting, the financial analysis, management and audit. Has handed over seven promotion examinations.	<p>Accountant CIPA knows:</p> <ul style="list-style-type: none"> - The international standards of the financial reporting (including the most difficult standards); - The tax legislation; - The economic right; - Management accounting in full; - The financial accounting in full; - The international standards of audit. <p>Is also able to apply, interpret, analyze IFRS, to do forecasts and to make independent decisions in sphere of management accounting, management of the finance.</p> <p>Has skill of preparation of the financial reporting, qualitative analysis of the financial information and use of professional judgement in acceptance of the important administrative decisions.</p> <p>Accountant CIPA is obliged to increase the qualification constantly.</p>
CAP (Certified Accounting Practitioner).	The owner is the certificated practising accountant, can lead	<p>Accountant CAP knows:</p> <ul style="list-style-type: none"> - The international standards of the financial reporting (except for some most difficult standards);

	accounting, constitute and analyze all kinds of the reporting on IFRS. Has handed over three promotion examinations.	- The tax legislation; - Bases of the economic right; - Management accounting bases; - Bases of the financial accounting. Is able to apply, interpret and analyze the basic international standards of the financial reporting. Has skill of preparation and the financial reporting analysis. Accountant CAP is obliged to increase the qualification constantly.
DipIFR (Diploma in International Financial Reporting).	The owner of the diploma can keep accounting of the companies and constitute all kinds of the reporting according to IFRS. The diploma is issued without qualification / assignment. Has handed over one promotion examination.	The accountant has base knowledge in area: - The international standards of the financial reporting (IFRS); - The international standards of the account (UK GAAP). Is able to apply and interpret the basic international standards. Has skill of preparation of the financial reporting according to the international standards, including the reporting of the groups including affiliated and associated companies and joint ventures.
IAB (Diploma in Accounting and Advanced Book-keeping).	The owner of the diploma can lead company book keeping under the international standards. The promotion examination is not provided.	The accountant has base knowledge in area: - The international standards of the financial reporting (IFRS). Is able to apply the basic international standards. Has skill of preparation of separate kinds of the financial reporting according to the international standards.
GRP (Global Remuneration Professional).	The owner is the professional under indemnifications and privileges.	The accountant has knowledge in the field of indemnifications and privileges. Is able to develop system of motivation of staff. Has skill of preparation and introduction of systems of motivation of staff.
The certificate 1C:Professional (version 8).	The owner of the certificate has successfully handed over testing under the program indicated in the certificate. Has successfully handed over testing.	The accountant has knowledge and can effectively use in the work typical configurations of programs of automation accounting, operative trading-warehouse, management accounting and wages account.
Certificate "Consultant plus".	The owner of the certificate is the professional user of systems the Consultant Plus. Has successfully handed over testing.	The accountant knows and the Consultant Plus can effectively use in the work legal-reference systems. The Consultant Plus is able to use the expanded possibilities of document retrieval in systems. Has skill: - The comprehensive analysis of an interesting question: opinion of official organs, judiciary practice, opinion of experts; - Duly tracing of changes of the legislation.

Further it was offered to experts on the basis of the matrix of mark estimations presented in picture 16 to mark points to employees of accounting service, responsible for record-keeping on a certain plot. In case of absence of formation and any rates the point 0 was exhibited.



Picture 16. Matrix of estimation

Thus, to each employee chosen for an estimation the corresponding point is pirated. It is logical that in this case estimations of experts will coincide. Thus, it has been evaluated five employees, the received results are presented in table 15.

Table 15. Factor estimation «Qualification of staff»

Position	Numerical score
Chief accountant	9
Deputy Chief accountant 1	7
Deputy Chief accountant 2	3
Tax accountant	6
Accountant responsible for «production»	4

The factor "Experience" is understood as work term in accounting department. It has been established that the operational experience on a responsible position or as a whole in accounting department for less, than two years, is undesirable. As much as possible experience is acquired for five years. Results of an estimation are presented in table 16.

Table 16. Estimation of the factor "Experience"

Position	Years
Chief accountant	12
Deputy Chief accountant 1	2

Deputy Chief accountant 2	8
Tax accountant	6
Accountant responsible for «production»	15

Factor “Accounting policy neutrality”. For an accounting policy estimation by criterion "neutrality", the test (table 17) where experts should mark to each chosen method points has been offered to experts. The point on each chosen method developed of two components: weight and desirability level (μ).

In this case the method weight was understood as a quantitative estimation. Thus, if the chosen method influences any article of the financial reporting which significance exceeds importance level the choice of a method of accounting is essential also significance of its weight – 1 if the chosen method influenced only the insignificant article of the financial reporting the method weight accepted significance - 0,5. Importance level has been established by experts and has constituted 5 % from balance currency. If this or that method is not fixed in an accounting policy, experts, having conducted interrogations of the chief accountant and the accountant responsible for a plot and having collected necessary proofs (account registers, basic documents), established - what method has been used.

Desirability level (μ) was advanced by experts proceeding from the following estimation: 1 – the chosen method as much as possible objectively reflects an economic essence of operation, an asset/obligation estimation, or the income/cost; 0 - the method will lead to distortions in the reporting and use of the given method pursues the various aims of the organisation distinct from neutralities of the financial reporting. Significances 0,1; 0,2; ..., 0,8; 0,9 – intermediate significances of desirability.

Thus, the mark estimation was advanced under the formula 12

$$Point = Weight * \mu \quad (12)$$

It is natural that working out of the given test and furthermore the estimation of validity of the chosen accounting policy of the organisation from the point of view of a neutrality item is a difficult process which has included studying of features of business, engineering procedure, the current legislation analysis, realisation economic and financial estimates etc.

The given estimation of an accounting policy based on the serious analysis of a great number of standard documents in the field of book keeping and taxation regulation, thorough knowledge of features of activity of the enterprise, functions of structural divisions and their interactions, knowledge of current economic items of the enterprise and prospects of its further development etc. All necessary data have been received as a result of inquiries to chiefs of structural divisions of "ZMT"

Table 17. Neutrality accounting policy test

Object of accounting policy	Methods of accounting	Weight	μ	Points
Norms of travelling and living expenses.	The size of daily allowances according to the legislation. Amount of compensation of living expenses without confirming documents.			
Appraisal of property, obligations and economic operations.	In roubles and copecks. In roubles with reference of arising differences on financial effects.			
Revaluation of assets.	It is conducted as of the first of financial year. It is not conducted.			
Writing off of cost of assets no more than 10 thousand rbl. for unit.	By single writing off on production expenses (costs for sale). In process of use in production or in operation.			
Recognition of the acquired books, brochures and other editions.	As an assets. Single writing off on expenses in process of use in production or in operation.			
Charge of amortization of assets.	Linear method. Method of the reduced rest. Method cost writing off on the sum of numbers of years of term of useful use. Method of writing off of cost proportional to a factory load.			
Order of the accounting of the special equipment	As a part of fixed assets. In structure financially-manufacturing inventory.			
Accounting order of specially clothes.	As a part of permanent assets. As a part of is material stocks.			
Order of the accounting of special instruments and adaptations	As a part of permanent assets. As a part of is material stocks.			
Charge of amortisation of intangibles assets.	Linear method. Method of the reduced rest. Method of writing off of cost it is proportional to a factory load.			
Writing off of costs on each executed research, developmental, technological work.	Linear method. Method of writing off of costs to proportionally factory load. Either linear method, or method of writing off of costs to proportionally factory load (works, services) on each concrete work according to the separate order (order).			
Estimation of acquired materials.	On accounting prices. Under the acquisition actual cost.			
The accounting of acquired materials.	Without use of accounts 15-16. With use of accounts 15-16.			

Work in progress estimation.	Under the actual cost price. Standart-costing. Direct-costing At cost of raw materials, materials and half-finished products.			
Ready product estimation.	Actual cost Planed cost.			
Finished shipped product estimation	Actual cost Normative cost.			
Sales costs.	Direct-costing Standart-costing.			
Estimation of the acquired goods.	Buying cost. Actual costs. Sale prices.			
Reserve creation for depreciation of tangible assets.	Yes no.			
Creation of reserves on doubtful debts.	Yes No.			
Long-term indebtedness transfer on received a loan and to credits in the short-term.	Yes No			

As a result of accounting policy testing following results have been received:

The greatest possible quantity of points – 34.

Arithmetic-mean quantity of points on four experts - 19,5.

Factors “Neutrality of a contractual policy”. Influence of a contractual policy on accounting as it has already been noted in chapter II, consists in that through the chosen variant how the economic operation will be done in contract it can affect registration in accounting, thereby, setting a picture of a financial position of the organisation which is reflected in its accounts. The accounts contents, in turn, influences opinion of its users on financial well-being of the company and on their concrete decisions consisting, for example, putting or to place money in certain projects of the organisation, to purchase or sell its shares, to grant or not to grant the organisations by the loan etc.

For an estimation of a contractual policy all agreements bargains on which exceed the established level of importance have been enquired. Importance level has been established by experts and has constituted 5 % from balance sum. Also typical agreements have been analyzed.

After an estimation of contracts experts have come to unanimous opinion that the contractual policy does not influence a financial reporting neutrality.

The factor «changes in an accounting policy and methodology». For an estimation of changes in an accounting policy and methodology the test presented in table 18 has been offered to experts. On each element the expert pirates an estimation on a five-point scale.

Table 18. The test for revealing of changes in an accounting policy

Check element	Procedures	Points
Invariance of an accounting policy during an accounting period on which it is accepted	Inspection of documents and the facts, inquiry and acknowledgement. Qualification of the added (excluded) positions of an accounting policy as changes. The analysis of legal validity and economic feasibility of changes.	
Fastening of admissible changes by the organizational-administrative document.	Inspection of the order of the chief about modification of an accounting policy (to formal signs).	
Submission of index numbers according to the changed accounting policy.	Check of recalculation of the data of last year by a new technique. Accounts inspection for a financial year (indicators for last year should be corrected), and also accounts and registration registers for last year (adjustment records should not be in connection with change of an accounting policy of financial year).	
Disclosing of changes of an accounting policy in reporting.	The control of filling of forms of account (carrying over of indicators from registration registers). Inspection of the explanatory note for a financial year.	

It has not been revealed changes in an accounting policy and account methodology.

The factor «Truthful submission» (Reliability). By the offered technique in Chapter II experts had been carried out the analysis of financial indexations. The analysis of financial indexations for revealings of errors and distortions in the reporting was made on the base of the Benesh model which was also modified. On each indicator the expert is offered to mark points:

3 – if the indicator does not testify to possible distortion;

2 – if the indicator testifies to possible distortion, but to the expert the facts which have led to change of the indicator are known;

1 – if the indicator testifies to possible distortion and to the expert the facts which have led to change of the indicator are not known.

On all doubtful indicators by experts chiefs, employees of an economical department, together with the chief accountant have been interrogated. The commission was exhaustive explanations of changes of indicators are received.

The received results with arithmetic-mean significance of points on four experts are presented in table 19

Table 19. The analysis of financial indexations

Factor	2006	2007	Points	Comments
Income-growth rate	1,4	0,5	3	If the rate of marginal revenue in the income decline is more than 1 its share in a revenue from sales was reduced. "Quality" of arevenue has accordingly decreased and, as consequence, company prospects in the market have worsened. Thus if the revenue from sales grows (income growth rate more then 1), and the share of the marginal revenue in a income decreases, it is signs of distortion in the financial reporting
Marginal revenue in income decline rate	1,13	2,13	2	
Asset quality growth rate	0,87	0,93	2,75	If the growth rate of an asset quality exceeds 1, the company, most likely, increases a share of extranegotiable assets in a total volume of assets. The growth of the extranegotiable assets which have been not connected with increase of quantity of permanent assets, can testify to unreasonable capitalisation of costs
Receivables turnover growth rate	0,37	1,47	2	In stable environments or moderate growth of business this indicator will remain approximately at one level. The situation when the debt receivable turnover sharply increases or decreases can testify to distortion. In the first case the probability of that manipulations with a income from sales are carried out is great, in the second – it is impossible to exclude that a debt receivable is artificially overestimated
Share of expense sin sales income growth rate.	1,01	1,04	1,75	The growth rate of a share of costs in a company income should not differ from growth rates of sales essentially. If the growth rate of a share of the costs comes to the rescue from sales, essentially deviates 1, most likely, it is deformed either a cost of sales, or a income
Amortization growth rate	0,65	0,67	3	The growth rate of a share of depreciation charges is approximately equal in usual conditions to unit. Hence, in case of sharp change of the given indicator it is possible to draw a conclusion on probable distortion in the financial reporting
Financial leverage growth rate	2,8	1,5	2	The commercial value of shares of company depends on size of the financial leverage. For the increases purpose of a commercial value of shares the company management can artificially to underestimate level of the financial leverage, including accounts payable in profit structure. In such cases growth rates of the financial leverage will essentially fluctuate
Liquidity rate changes	1,47	1,10	3	The liquidity rate allows to evaluate ability of the company to cover current obligations that characterises its solvency. In a case if it will be underestimated sizes of obligations the overall liquidity of the company will be sharply changed.
Current liquidity rate changes	3,19	1,6	1,75	Unlike changes of factor of overall liquidity, the factor of current liquidity is more sensitive to distortions with debt

				receivable.
Material turnover (days)	assets rate	1,2	2,7	2
For the purpose to deform profit interested persons can use various schemes on overestimate of the cost price of sales. If the cost price of sales has been overestimated, and the size of material stocks thus was not deformed, the ratio to sales of material stocks will increase. And on the contrary, if the size of material stocks will decrease in comparison with the previous period is overestimated. Hence, the essential deviation of rate of change of the turnover time of material stocks from 1 can be regarded as a signal about distortion in the financial reporting.				

The greatest possible score – 30

The sum of arithmetic-mean points on four experts – 23,25

The factor «Risks of registration process». For an estimation of risks of registration process experts allocated essential operations and according to Chapter III of the given work models of registration processes are constructed, descriptions of processes are conducted, risks are allocated and work by their estimation is conducted. At use of a scale for probability and the influence, consisting of three significances, possible significances of the expected size have been presented by a matrix (table 20).

Table 20. Estimation of the expected size of overall risk

P R O P A B I L I T Y	High-propability	Low	High	High
	Potential	Low	High	High
	Low-propability	Low	Low	Low
		Low	Midium	High
THE ESTIMATION OF THE LEVEL OF CONSEQUENCES				

Average significance of the expected size of overall risk on four experts – average.

Revealing of errors in the reporting by means of the associativity control. Experts had been conducted work in comparison of indicators of the financial reporting (annual and semiannual) for 2008 on the basis of a principle of interrelations of indicators of accounts. Associativity indicators of forms of accounting are shown in table 21. In case of the indicators equality of one form to an indicator (or to indicators) of other form the point – 1 was pirated. In case of an inequality – 0.

Table 21. Associativity indicators of forms of accounts.

Statement N 1	Statement N 3	Point
Section III. The capital and reserves.	Section I. Capital changes.	
Line 410, column 3.	Line 300, Column 3	
Line 410, column 4.	Line 310, Column 3.	

Experts had been conducted 30 associativity indicators of the financial reporting and estimated of 37 points from 41 possible.

The factor «Completeness of the account». For an estimation of the factor "Completeness" the test (table 22) has been offered to experts. It was necessary to mark points depending on this or that request to object of check and how many is fulfilled. During an estimation experts have resorted to sample of documents.

Table 22. The test of an estimation of criterion «Completeness of the accounting».

Element	Check object	Point
Chart of accounts	The control and analytical accounts necessary for book-keeping according to requests of timeliness and completeness of the accounting and the reporting.	0-5
Forms of primary registration documents	Applied to registration of the facts of economic activities basic documents on which model forms are not provided. Completeness of reflexion in them the necessary information.	0-5
Rules of document circulation and technology of processing of an accounting information	The document circulation schedule (static, dynamic), distribution of the functions, applied hardware, accounting programs.	0-10
Assumption of time definiteness of factors of economic activities	The facts of economic activities of the organisation concern that accounting period in which they took place, irrespective of actual time of receipt or payment of the money resources connected with these facts.	0-5
Registration of all operations	Completeness of registration in accounting of all facts of economic activities	0-10
Accounting organizational form	Centralised Decentralized The mixed	0-5
Accounting department organization	Position about accounting service. Duty regulations; Position about branches and other structural divisions. The internal control system organisation.	0-7
Information processing technology	Manual method; Manual method with partial application of means of automation Automated method	0-5
Technology of information processing	The document circulation schedule is approved. The persons responsible for storage of documents are defined	0-5
Timeliness	Duly registration of the facts of economic activities in accounting and an accounts (for informing of users and inclusion of indicators during the period to which they concern).	0-7
Continuous numbering	All documents are numbered. Observance of through numbering of documents.	0-10

Control order	Distribution of supervisory powers, order and conditions of realisation of auditing, internal and outside audit.	0-5
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Maximum quantity of points – 79

Arithmetic-mean quantity of points on four experts - 58

The factor "outside audit". For an estimation of criterion "External audit" we offered to use a rating of the auditor companies. Having considered various techniques of making up of ratings of the auditor companies, and also approaches to a choice of the auditor it has been advanced that ratings constituted by information-rating agency expert-analytical company "ЮНИПРАВЭКС" consider most wide sections both qualitative, and quantity indicators, therefore the estimation technique was under construction with allowance for the given annually published rating. The important factor of quality of external audit is also long-term relations with the auditor and experience of the enterprises checks of the same branch which the checked industrial enterprise concerns. Thus, the following test (table 23) has been offered to experts for external audit quality evaluation.

Table 23. The test of an estimation of the auditor company

Auditing company rating	Top 50	5 points
	Top 100	3 points
	Outsider	1 point
Cooperation (years)	1-3	3 points
	More then 3	5 points
Has client from the same branch of economy	Client estimation positive	5 points
	Client estimation - satisfied.	3 points
	There is no client from the same branch	1 point

It has been advanced by results of an estimation by experts that the factor "External audit" is evaluated in 7 points from 15 possible.

The factor «Quality of IC organisation». For an estimation of an internal control system the test (table 24) has been offered to experts. At a mark estimation of answers to questions it was recommended to start with the following:

- 1 — yes, to the full;
- 2 — basically, in most cases;
- 3 — partially, sometimes;

4 — is not present, never, including in case of absence.

Table 24. The internal control system test

Question	Point	Comments
The activity control of the company organized by management.		
Whether there the created system of bodies of the internal control corresponds to the positions provided by the charter, internal documents of the organisation, structure, an order of their formation and authorities?		
Whether the organisation has the internal documents advancing:		
Order of the organisation of an internal control system, including structure and the internal control system contents?		
Order and procedures of realisation of the internal control?		
The control over functioning of a risk management and estimation of risks.		
Whether bodies of the internal control of the organisation carry out on a constant basis the control over functioning of a risk management and an estimation of risks?		
Whether the order of informing of corresponding works managers of the organisation about factors (internal and external), influencing increase of level of risks is provided by internal documents of the organisation?		
Whether the service of the internal control carries out the control over efficiency of the measures ensuring decrease of level of revealed risks?		
The control over distribution of powers of operations and bargains.		
Whether the established order of distribution of powers between divisions of the organisation and employees of the organisation is observed by the organisation of operations and bargains by means of the material (physical) control?		
Whether distribution of functions is ensured so that to exclude a possible conflict of interests		
Whether the order of revealing and the control over areas of a potential conflict of interests of employees for the purpose of exceptions of possibility of concealment by them of wrongful acts is established by the enterprise?		
Whether reports and the information on results of activity of structural divisions with the purposes of revealing of defects of the control, infringements, errors are granted board of directors (supervisory board), organisation executive powers, and also the chiefs of structural divisions corresponding to committees etc. ?		
Whether verification of reports on observance of limits (if are established) on realisation of operations with the data of basic documents is carried out?		
Whether the system of the coordination (assertion) of the operations (bargains) exceeding established limits, providing duly informing of corresponding works managers (its divisions) on such operations (bargains) operates in the organisation?		
Whether check of observance of an order of fulfilment of operations and bargains with simultaneous informing of corresponding chiefs of the organisation on the revealed infringements, errors and defects is carried out in the organisation?		
Whether adjustment of accounts with simultaneous informing of corresponding chiefs of the organisation on the revealed infringements, errors and defects is carried out in the organisation?		
The control over management of informational flows (reception and a communication of information) and maintenance of information safety.		
Whether ensures the order of the control established by the enterprise timeliness, reliability, confidentiality, correctness of registration of the information?		
Whether the procedure carries out under the general control of the automated information systems?		
Whether carries out the enterprise the program control of operations and bargains?		
Whether are established by the enterprise of the rule of management of an information work, including an order of protection against unapproved access and confidential information distribution?		
Whether plans of action on a case of the unforeseen causes with use of duplicating (reserve) systems and (or) systems are developed by the organisation?		
Whether the procedure for test of plans of action is observed?		

Supervision carried out on a constant basis over internal control system functioning (monitoring IC).		
Whether the enterprise has the internal documents advancing an order of monitoring of an internal control system by board of directors (supervisory board), organisation executive powers?		
Whether the monitoring order is observed by the enterprise?		
Whether the constancy of activity of service of the internal control is ensured by the enterprise?		
Whether independence of service of the internal control is advanced in internal documents of the enterprise?		
Whether the request to professional competence of the chief (its deputies) of the internal control services are established?		
Whether the service of the internal control of checks according to the plan approved by board of directors (supervisory board) of the organization or by authorized by body carries out?		
The information and system of its transfer		
Whether the automated system of the enterprise limits access to the information of any interested user?		
Whether the position or the rules, concerning formations, transfers and protection of the intrafirm reporting are developed at the enterprise?		
Monitoring of activity and correction of defects.		
Whether adequacy and effectiveness of an internal control system traces by executive management the enterprise (management)?		
Whether general efficiency of the internal control is evaluated on a constant basis?		
Whether the program of coordination of activity (interaction) external and organisation internal audit is developed?		
Whether the cycle of audit chosen in the plan (term of the plan of audit) is adequate to promptness to operations conducted by the organisation?		
Whether the order of revision of the plan of audit is provided in the organisation?		
Whether an intrafirm procedure of the analysis of the reporting is carried?		

Thus quality IC estimation was defined as following:

$$Q = (Q_m \times C_1 + Q_{ia} \times C_2 + Q_{ea} \times C_3) / (C_1 + C_2 + C_3), \quad (13)$$

Where Q - quality estimation of IC;

Q_m - quality estimation of IC defined by management;

Q_{ia} - quality estimation of IC defined by internal audit;

Q_{ea} - quality estimation of IC defined by external audit;

C_1, C_2, C_3 - the weight advanced on the basis of expert appraisal.

Average significance of Q have designated as avg. Q and it means a average score of the answer to a question of IC test and can be find using the formula 14.

$$Avg. Q = Q/n, \quad (14)$$

Where n – quantity of questions.

With the purposes of the present technique experts had been accepted the following weights of quality (table 25):

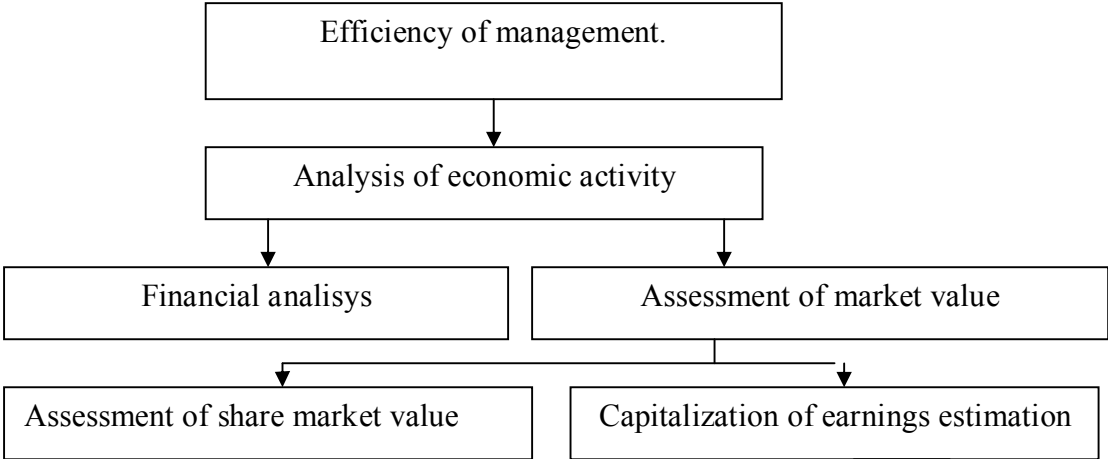
Table 25. Weight of quality

Quality of the IC defined by management	0,3 (C1)
Quality of IC defined by internal audit	0,3 (C2)
Quality of IC defined by external audit	0,4 (C2)

Definition of concept of the internal control in Chapter II shows that a system main purpose is efficiency of activity of the organisation. Thus, the financial analysis can show a management efficiency and as consequence, indirectly, efficiency of the internal control

The analysis of theoretical researches in the field of management performance evaluation allows to draw a conclusion on availability of various methods. The following classification of techniques of the estimation is offered to use in modern conditions (picture 17).

Quantitative techniques of performance evaluation of management are based on the corporation management accountancy. The given group of techniques is subdivided into methods of valuation of financial circumstances and commercial value methods of valuation.



Picture 17. Techniques of performance evaluation of management

Statistical method (quantitative estimation). The given method is based on definition of financial indexations of an indicator as necessary condition of effectiveness. Besides, here the quantative estimation of activity of internal control are applied.

On each of indicators criteria (points) of IC quality settle up. Quantitative quality IC evaluation represents average arithmetic, calculated proceeding from the indicated points.

1. Earnings record.

$$Kpn = (PI / Pav), \quad (15)$$

where Kpn — earnings growth rate; PI — balance sheet profit; Pav — average annual balance return.

2. Return on assets.

$$PCK = (E/Aav)*100, \quad (16)$$

where PCK – return on assets; E – earnings before interests and taxes; Aav – average accrued total of assets.

3. Financial stability index.

$$FSI = (OE + LLC)/TB, \quad (17)$$

где OE – owner's equity; LLC – Long-term loan capital; TB – total balance.

Activity of internal control department.

Asset growth and control procedures ratio:

$$A = ((Q1 / Q0) / (A1 / A0) - 1), \quad (18)$$

где A — Activity of internal control department; $Q1$, $Q0$ — quantity of control checks (procedures) in the beginning and end of the year; $A1$, $A0$ — gross assets in the beginning and the end of the year.

Significance of points of quality on each indicator which are resulted in table 3. have been defined with allowance for branch feature of "ZMT" by experts

Table 26. Quality points

Factor	Points of quality			
	1	2	3	4
Earnings record	More then 0	(-0,49)-(0,0)	(-0,74)-(-0,50)	Less then -0,75
Return on assets	More then 30	29 - 20	19-10	Less then 9
Financial stability index	More then 0,5	0,49 – 0,3	0,29 – 0,1	Less then 0,1
Activity of internal control department.	More then 0	(-0,49)-(0,0)	(-0,74)-(-0,49)	Less then -0,75

Thus, quantitative quality evaluation of IC (Qq) have defined as a score of points on each indicator of table 26. Hence that it is possible to express average significance of quantitative quality evaluation through the formula

$$Avg Qq = Qq/n, \quad (19)$$

Where n – quantity of indicators.

Significances of points of quality on each indicator are resulted in table 26. The total estimation of an internal control system in the organisation is recommended to be defined depending on significance of an indicator of a degree of quality on the basis of the conformity table (table 27). Table 27 is a resultant of the technique describing an end result of an estimation. The degree of quality is defined as the average indicator of quantitative and qualitative estimations and settles up as follows:

$$Tq = (Avg Q * B1 + Avg Qq * B2) / (B1 + B2), \quad (20)$$

Where Tq — a degree of quality;

$Avg Q$ — quality estimation of IC;

$Avg Qq$ — quantitative quality evaluation of IC;

$B1, B2$ — the weight defined on the basis of expert appraisal.

With the purposes of the present technique the following of weight of quality evaluations (table 27) was accepted:

Table 27. Weight of quality evaluations

Qualitative evaluation of IC quality	0,5 (B1)
Quantitative evaluation of IC quality	0,5 (B2)

Weight factors reflect the relative importance of each indicator.

Table 28. Conformity of total evaluation of an internal control system quality and significance of an indicator of a degree of quality of an internal control system

Level of quality	Qualitative	Qualitative with insignificant weakness	Needs attention	Defective
Meaning of value	$K \leq 1,6$	$1,6 < K \leq 2,5$	$2,5 < K \leq 3,4$	$K > 3,4$

It has been defined By results of an estimation of an internal control system of "ZMT" ($T_q = 2,9$) by experts that the internal control system requires attention from chiefs and proprietors.

The factor «Completeness of registration of the essential information in the reporting». Experts, conducting an estimation of factors of the second order influencing quality of the financial reporting, were based on the professional judgement and have come to opinion, that not the all essential information is presented in the reporting. The given conclusion has been received during the review of documents, conversations with a management. The commission has made a conclusion that there is an information which can affect opinion of the user at decision-making, and that the given information should be reflected to the full in the explanatory note. Proceeding it from their level of desirability for the factor «completeness of registration of the essential information in the reporting» has been established at a rate of 0,6

The factor «Information filters».

For an estimation of degree of influence of information filters it was offered to experts, being based on the present information received during an estimation of all factors of the second order, conversations and explanatories of employees and managements, to state a mark estimation of degree of influence of this or that filter. And also to evaluate cumulative influence of information filters. On each filter it was suggested to mark points:

- 1 – significant influence;
- 2 – insignificant influence;
- 3 – influence on quality of the reporting does not render.

The received results, namely arithmetic-mean significance on four experts are presented in table 29.

Table 29. Estimation of information filters

Filter name	Points
Organizational imperfection	2,75
Low qualification-1	2,5
Low qualification-2	3
Method of processing of information	2
Successful installation	2
Real power	2
Resistance of middle management	3

The maximum arithmetic-mean significance of a cumulative estimation has constituted 3 points. According to experts, arithmetic-mean significance of a cumulative estimation equal to 2,46.

Thus, the commission of experts at the given stage had been evaluated all influencing factors of the second order.

Stage 4. The Mathematical model of an estimation of factors of the second order. At the given stage experts had been constructed functions of desirability for each factor of the second order, and also significances of functions of desirability according to the estimations conducted at 3 stage. The received results are presented in the aggregate table 30.

Table 30. Significance of function of desirability of factors of the second order

Factor	Meaning	μ
Accounting policy neutrality.	19,5	0,63
Contractual policy neutrality.	All contracts are neutral	1
External audit quality.	7	0,6
IC quality.	2,9	0,31
Accountants qualification (estimation μ is average for each employee).	5,8	0,47
Accountants experience (estimation μ is average for each employee).	2	0,82
Information filters.	2,46	0,89
Accounting process risks.	Middle	0,5
Errors in reporting (associativity indicators)	37	0,97
Possible distortions (financial analysis).	23,35	0,82
Completeness of accounting process.	58	0,82
Completeness of essential information.	Defected	0,6
Changes in accounting policy and methodology.	No	1

Stage 5. Ranging of factors of the second order. At the given stage experts had been filled matrixes of paired comparisons of the factors importance of the second level, and also their ranks were defined. Judgements of experts were based on organizational and branch features of "ZMT". The received results are presented in tables 31 – 36.

Table 31. Matrix of paired comparisons for the factor "Personnel"

Personnel	Qualification	Experience	Rank
Qualification	1	3	0,75
Experience	1/3	1	0,25

Table 32. Matrix of paired comparisons for the factor "Neutrality"

Netrality	Accounting policy neutrality	Contractual policy neutrality	Rank
Accounting policy neutrality	1	4	0,8
Contractual policy neutrality	1/4	1	0,2

Table 33. Matrix of paired comparisons for the factor "Audit quality"

Audit	External audit quality	IC quality	Rank
External audit quality	1	1/6	0,14
IC quality	6	1	0,86

Table 34. Matrix of paired comparisons for the factor "Faithful representation"

Faithful representation	Financial ratio analysis	Accounting process risks	Associativity indicators check	Rank
Financial ratio analysis	1	1	4	0,46
Accounting process risks	1	1	3	0,42
Associativity indicators check	1/4	1/3	1	0,12

Table 35. Matrix of paired comparisons for the factor "Completeness"

Completeness	Completeness of accounting process	Completeness of essential information recognition in reporting	Rank
Completeness of accounting process	1	1	0,5
Completeness of essential information recognition in reporting	1	1	0,5

Stage 6. Ranging of factors of the first order. At this stage the matrix of paired comparisons of factors of the first order constructed and their ranks are calculated.

Table 36. Matrix of paired comparisons of factors of the first order

	Personnel	Neutrality	Filters	Comparability	Completeness	FP*	Audit quality	Rank
Personnel	1	1/3	5	1/3	1/3	1/3	4	0,104
Neutrality	3	1	1/2	1	1	1	1	0,134
Filters	1/5	2	1	1/5	1/5	1/8	1/8	0,039
Comparability	3	1	5	1	1	1	3	0,218
Completeness	3	1	5	1	1	1	1	0,186
FP*	3	1	8	1	1	1	1	0,199
Audit quality	1/4	1	8	1/3	1	1	1	0,12

*FP – Faithful representation

Stage 7. An estimation and convolution of factors of the first order and an estimation of a global quality indicator of the financial reporting. At the given stage it has been carried out (with allowance for the found ranks) curling of factors of the second level in factors of the first, and factors of the first level into the uniform global criterion characterising the general quality of the reporting. The data is presented in table 37.

Table 37. Estimation of factors of the second order

First level factors	Second level factors	Desirebility	Second level factor rank	First level factor	First level factor's rank
Neutrality	Accounting policy neutrality	0,63	0,8	0,704	0,134
	Contractual policy neutrality	1	0,2		
Comparability	Accounting policy and methodology changing	1	1	1	0,218
Information filters	Aggregate estimate of information filters influence	0,89	1	0,89	0,039
Audit quality	External audit quality	0,6	0,14	0,35	0,12
	IC quality	0,31	0,86		
Completeness	Completeness of accounting process	0,82	0,5	0,71	0,186
	Completeness of essential information recognition in reporting	0,6	0,5		
Faithful representation	Financial ratio analysis	0,82	0,46	0,703	0,199
	Associativity indicators check	0,97	0,12		
	Accounting process risks	0,5	0,42		
Personnel	Experience	0,82	0,25	0,557	0,104
	Qualification	0,47	0,75		

The global criterion of quality of the financial reporting was advanced under the formula $3. D (C1, C2 \dots C7) = 0,72$. In other words it is possible to tell that the degree of quality of the financial reporting of "ZMT" has constituted 72 % from desirable result.

4.3 Recommendations made to improve the IC of “ZMT”

Having conducted the SWOT-analysis experts it has been advanced that

1. To strengths of the financial reporting of the enterprise for 2009 is possible to carry low influence of information filters, absence of distortions in the reporting caused by the contract policy, an invariance of the chosen methods of accounting and reporting that guarantees comparability of results in dynamics, absence of errors at reporting drawing up, sufficient experience of chief accountants.

2. It is possible to carry a neutrality to weaknesses because of influence renders the chosen methods in the accounting policy (for example, such as absence of revaluation of assets etc.) And the chosen methods of accounting of the essential articles not completely reveal in the reporting. The auditor of company does not enter into a rating of 100 best auditor companies, besides, among its clients there are no enterprises of similar branch. Also experts have considered that cooperation with the auditor throughout 8 years can affect attentiveness and a pedantry at realization of checks and working out of recommendations that can negatively affect quality of external audit. Also having evaluated risks of registration process, experts mentioned the inability of existing control procedures to influence some essential risks, and also frequently absence of any control is revealed at high risks of errors, distortions and frauds. As it has been noted above, the essential information is not fully presented in the financial reporting. The weaknesses are qualification of employees of accounting division and quality of IC organization.

3. Experts have considered to carry absence of risk of probability of any sanctions and fines to possibilities from outside state structures because all legislatively established requests to the account and an accounting information have been observed.

4. To possible problems, in connection with not so appreciation of quality of the reporting, experts have carried a high level of probability of swindle from outside employees which is caused by low level of the control of safety of property. And also possible errors in decision-making on the basis of the financial analysis since its factors will be deformed.

The results of an estimation have been presented to "ZMT" board of directors, and also on their basis recommendations about the financial reporting quality improvement and reduction of influence of negative factors by reporting qualitative characteristics have been

formulated. In particular experts had been formulated the recommended changes in positions about the Auditing committee and internal audit services (see the appendix 2).

For improvement of an internal control system of “ZMT” it is possible to recommend:

1. Informers. Availability of "informants" - the most effective method of detection of fraud. In the western companies of an expert of use of informers among employees it is considered norm, and according to the western statistics so reveals to 40 % of all frauds. In Russia the relation to informers is traditionally ambiguous. It is possible to assume that in process of acceptance of codes of corporate ethics in the Russian companies such method of detection of fraud becomes more wide-spread.

2. To make changes to duty regulations of chiefs of the centers of responsibility and to oblige them, and to represent the information in accounting service in time in workmanlike manner.

3. The Developed forms of documents (not unified) to apply on an accounting policy which will be an accounting policy integral part.

4. Verification of accounts with constantly varying circle of counterparts – monthly.

5. To acquire the license program 1С:Бухгалтерия 8.0 and to sign the service contract and updatings.

6. To verify the data analytical, synthetic and the fiscal accounting monthly

7. To trace timeliness of settlement of debt and creditor indebtedness. To lead the control over terms of the payment of invoices for the purpose avoidance of fines for contractual delinquency.

8. To carry out the quarter analysis of the periodic financial reporting with tracing of the reasons of changes of factors, and also the semi-annual analysis of the reporting on signs of fraud on the basis of the Map of standard deviations of financial indicators.

9. To oblige the chief accountant or internal auditors to carry out intrafirm study of times in a month, weekly to conduct the review of acts (legislative acts) (in an company line of business) and the periodic literature.

It is necessary to mention that on a base of the financial reporting quality control offered by thesis auditing company “Izh-ingeneering” have made the review of financial reporting of its client OAO “Udmurtagrosnab” (see the appendix 1). The independent auditor had been conducted the review of the financial reporting and Open Society OAO “Udmurtagrosnab” internal control system being based on the federal statute «About auditor activity» by the Federal rules (standards) of auditor activity approved by the Governmental order of the Russian Federation from 23.09.2002 № 696, and also on intrafirm standards and experience. Also the review was based on ISA. It is necessary to notice that external and independent audit was not conducted and, accordingly, the auditor did not express the opinion. The review has been conducted before approbation of a technique of quality evaluation of the financial reporting and after introduction of the recommendations received as a result of quality reporting control. The results of the review have shown effect from introduction of the concept of quality assurance of the financial reporting: significant improvement IC that interferes with occurrence of errors and a deceit, and also does accounting records more reliable, and administrative decisions more effective. And also realization of less detailed auditor checks of separate documents and operations that in general reduces expenses for outside audit.

CONCLUSION

There is an imperative need of ordering and expansion of an arsenal of analytical instruments to help the enterprises organize and evaluate the Internal Control. As the professor Sokolov J.V. marks.: «the ability of the user accounts to advance, at what stage of development there is a firm - its primary goal as the responsible financier, as any other user. The main goal of the administration and, first of all, the responsible financier to do his best to prolong the third stage of firm evolution (maturity). At the present stage the questions of information supply are the integral part of economic policy and strategy, not only on a company level, but on a national level.

Realisation of the weighed macroeconomic policy on the states level and on the concrete enterprises, creation of a favorable conjuncture in the world markets is impossible without application of the concept of quality assurance of the financial reporting.

While efficient use of the given concept at microlevel there is an improvement of the indicators characterizing IC and it is observed increasing efficiency of the decision-making. The concept of quality assurance of the financial reporting of the enterprise also executes social functions by realisation the strategic problem of social and economic development - to support the growth of quality degree, transparency of the financial reporting and knowledge of the population that reduces mistrust to the reporting and develops the market of investments.

The Government of the Russian Federation considers the quality of the economic information at the present stage economic development as one of key elements of improvement of an investment climate and as an exit of the world financial crisis.

The organisation of quality assurance of the financial reporting of the enterprise is actual for the enterprises of various patterns of ownership and organisation-legal forms and is a part of the anti-recessionary management, that allows to prevent crisis situations.

Now the insufficient attention is given to questions of conformity to qualitative characteristics and requests of the used information for acceptance of administrative decisions. The analysis of factors influencing quality of the financial reporting practically is not used. In modern conditions of managing, when the economic and political situation varies so often that it is practically not possible to follow it, the management of any managing subject should undertake constantly measures for activity stabilization.

Market economy development predetermines necessity of perfection not only the rational forms of managing in every possible way adapted for fast varying conditions of external and internal economic environment, but also adequate control systems at all levels and, first of all, in the large-scale industrial subject.

To "survive" in modern conditions the managing subject should have the accounting and analytical information which, on the one hand, ensures formation of the authentic accounting (financial) reporting that is confirmed as a result of outside audit, and with other - allows to produce and make the administrative decisions predicting dynamism of the varying market infrastructure; to operate new customer relationships with clients and partners during the realisation of various economic processes (supply, production, sales, etc.).

Among the most significant theoretical and new practical approaches it is necessary to allocate formation of an effective system of economic management by the managing subject and its subsystems — the internal control, owing to that the order of the control over economic operations affirms the chief of the managing subject as a part of its accounting policy.

The internal control which is an integral part of a control system of the managing subject is a form of a feedback, due to it the subject, that operates the system, receives the necessary information about its valid condition for the correct estimation that had been actually made and to reveal the deviations from the set parameters.

The requests to an internal control system of the companies leaving on share markets of the USA and Europe at legislative level are determined:

- Internal Control – Integrated Framework. The Committee of Sponsoring Organizations of the Treadway Commission⁹¹;

- Internal Control: Guidance for Directors on the Combined Code.⁹²

It is necessary to notice that in The Czech Republic and Russia the greatest distribution was received by requests to an internal control system, established by the legislation of the Western countries. The big resonance has caused by innovations that joined into force in March 2005., by acceptance Sarbanes-Oxley act in the USA. So, according to requests of Chapter 404 SOX it is necessary for public companies to present the management

⁹¹ The Committee of Sponsoring Organizations of the Treadway Commission's. *Internal control - Integrated Framework* <www.coso.org> Committee of Sponsoring Organizations of the Treadway Commission *Internal Control –Integrated Framework. Guidance on Monitoring Internal Control Systems*. Discussion Document. September 2007. <www.coso.org>

⁹² The Institute of Chartered Accountants. *Internal Control: Guidance for Directors on the Combined Code*. September, 1999. ISBN 1 84152 010 1. <<http://www.cg.org.cn/theory/zlyz/turnbull.pdf>>

report about an internal control system condition behind financial reporting drawing up. And the internal control system condition behind financial reporting drawing up is advanced by its efficiency and comes under to a constant estimation which in turn includes documentary disclosing of the information on any significant defects of system. In addition to all the management has not the right to state a positive estimation of an internal control system in the presence of one and more significant defects of its functioning.

While evaluating SOX requests it is obvious that all of them are directed exclusively on a regulation of the financial reporting control by the enterprises that seems like limited approach to the internal control system organization.

Despite on wide application of requests SOX to an internal control system, practice shows that highly wasteful actions for fulfillment of the given requests regarding record-keeping and the control are insufficiently effective.

In turn the European approaches to an internal control system are less regulated and frequently have recommendation character. In many countries so-called Codes of corporate behaviour (Codes of Corporate Governance) are entered. Therefore, creating an internal control system at any enterprise, including ones that doesn't pass listing at stock exchange, it makes sense to familiarise with the given workings out.

The requirement for internal control system creation at the enterprises is caused not only by requests of share markets, but also necessity of maintenance by a trustworthy information about assets and obligations of the companies, and also struggle against the abusings connected, for example, with no-purpose draught on funds or infringement of the legislation.

The internal control system should be considered as the integral process of all operation of the company, otherwise, as the practice shows, the given system will be much wasteful, or have low efficiency. Creation and system development of the internal control should lean not only on statutory requirements regarding an exit on a share market, but also on requirements of proprietors, and also requirements of a management of the companies. The correct methodology of introduction and use, and also corresponding software products will allow to organize accurately functioning internal control system.

Thus, along with strategic problems before the maximum management of managing subjects there is a problem of accurate, correct and duly reaction to any changes both in the most managing subject, and in the environment. Only at constant tracing of factors

influencing financial reporting qualitative characteristics there is a possibility of their accurate fixing and acceptance of duly measures on liquidation of undesirable consequences.

Along with it, it is necessary to notice that possible negative consequences from delayed or wrong decisions mention not only the managing subject, but also other categories of subjects of society connected with it. And the more subjects are involved in a sphere of interest of the managing subject, the more resonance is received by errors in management. According to the author of dissertation, the term most full reflecting managerial process by an industrial enterprise by means of the internal control, the term of "financial reporting quality assurance» is.

In the dissertation the scientific problem – classification of major factors influencing on qualitative characteristics of the financial reporting and creation a technique of quality evaluation of the reporting in a kind multicriteria characteristics is delivered and decided.

The author of dissertation had been carried out the analysis of concept of quality assurance of the financial reporting. The analysis has shown that the problem of management of industrial enterprise activity is especially actual for a present stage of development of the Russian economy as there is a process of reforming of book keeping. It is revealed that there is a necessity of effectivization of administrative activity. It causes necessity for system development of the account and working out of quality evaluation of the financial reporting.

As a result of the decision of this problem in dissertational work the concept of quality evaluation of the financial reporting is developed.

Results of the dissertational research give the grounds to offer following clarification of the financial reporting quality: set of the characteristics realised in a target accounting information and their significances concerning its ability to satisfy established and prospective information requirements of user, and also balance between its qualitative characteristics with allowance for the restrictions connected with inquiries and expectations of users

In the dissertation necessity of realisation of an estimation of the financial reporting on a meeting the requirements to qualitative characteristics which is an independent direction in system of the intraeconomic control has been shown and it allows to evaluate quality of the financial reporting.

In order to evaluate factors influencing on qualitative characteristics of the financial reporting of an enterprise were classified and systematised.

The concept of an estimation of influencing factors with use of fuzzy logic bases is offered, the documentation is developed for an estimation.

The methodical aspect of quality evaluation of the financial reporting in a kind multicriteria characteristic that consolidate the major qualitative characteristics, giving in to the description by means of qualitative and the quantity indicators advancing possibility of its use for acceptance of administrative decisions by users, as bases for process of construction and constant improvement of an industrial enterprise's internal control is offered.

For the effect diagram to reflect all activity of the enterprise, indicators reflecting influencing factors should be multicriteria, complex and to include both quantitative and qualitative, financial and non financial criteria.

Therefore it is necessary to select the indicators establishing a relationship of cause and effect as only they open essence of the considered phenomena. Financial reporting quality assurance allows to connect the development strategy of an internal control system as a whole with its urgent procedures of perfection.

Working out of methodology of research of the organisation of the internal control and financial reporting quality evaluation in managerial process by an industrial enterprise acquires a special urgency in the conditions of reforming of the Russian book keeping according to the international standards of the financial reporting and transformation of system of standard regulation of the Russian audit on the basis of the international standards of audit when there is a necessity for the information representing an objective picture of a financial position and results of activity of managing subjects.

The technique of settlement quality evaluation of the financial reporting allows to evaluate and trace level of an internal control system not only is qualitative, but also quantitatively. Possibility of realisation of a correct settlement estimation of a condition of quality of the financial reporting and an internal control system ensures efficiency of acceptance of the administrative decision in and allows to organize an internal control system more rationally.

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Appendix 1

В диссертационную комиссию
по присуждению ученой степени PhD
при Факультете Бизнеса и Менеджмента
Технологического Университета г. Брно

Отчет независимого аудитора по обзору финансовой отчетности и системы внутреннего контроля ОАО «Удмуртагроснаб»

Аудиторской организацией ООО «Иж-инжиниринг» (место нахождения – Удмуртская Республика, г. Ижевск, ул. Шумайлова, д.20; лицензия №Е002714 на осуществление аудиторской деятельности сроком до 10 декабря 2012 года) проведен обзор финансовой отчетности и системы внутреннего контроля ОАО «Удмуртагроснаб».

Мы не проводили аудит и не выражаем свое мнение. Обзор выполнен как сопутствующие аудиту услуги согласно Федеральному закону «Об аудиторской деятельности» от 30 декабря 2008г. №307, федеральным правилам (стандартам) аудиторской деятельности, утвержденным Постановлением Правительства РФ от 23 сентября 2002г. №696, а также внутрифирменным стандартам.

Полученные результаты обзора и рекомендации аудиторской организации сопоставимы с выводами, полученными в результате внедрения методики контроля качества финансовой отчетности, предложенной диссертационным исследованием Гафарова Т.М.


Методика расчетной оценки качества финансовой отчетности, разработанная Гафаровым Т.М., позволила ОАО «Удмуртагроснаб» оценивать и отслеживать уровень системы внутреннего контроля не только качественно, но и количественно. Возможность осуществления корректной расчетной оценки состояния качества финансовой отчетности и системы внутреннего контроля обеспечила эффективность принятия управленческого решения в ОАО «Удмуртагроснаб», что позволило более рационально организовать систему внутреннего контроля.

Директор ООО «Иж-инжиниринг»



Т.М. Романова

Appendix 2

	открытое акционерное общество
	КОНЦЕРН «АКСИОН»
	ОАО «ЗМТ»
	ул. М. Горького, 90, г. Ижевск, Удмуртская Республика, 426000, тел.: (3412) 78-65-43, 56-07-68 факс: (3412) 51-12-97, телетайп: 255145 «ЗАМОК» ИНН/КПП 1831042315/183101001


№ _____
На № _____ от _____

В диссертационную комиссию
по присуждению ученой степени PhD
при Факультет Бизнеса и Менеджмента
Технологического Университета г. Брно

СПРАВКА
о внедрении результатов научного исследования
докторанта кафедры «Финансы»
Технологического Университета г. Брно
по теме: «Контроль качества финансовой отчетности для построения системы
внутреннего контроля»

Настоящая справка о том, что результаты и методы диссертационного исследования Гафарова Т.М. апробированы и внедрены на ОАО «Завод медицинской техники» в систему управления, представляют практическую значимость и существенно повышают эффективность принятия управленческого решения. Материалы исследования могут иметь широкое практическое применение

Директор
ОАО «Завод Медицинской Техники»



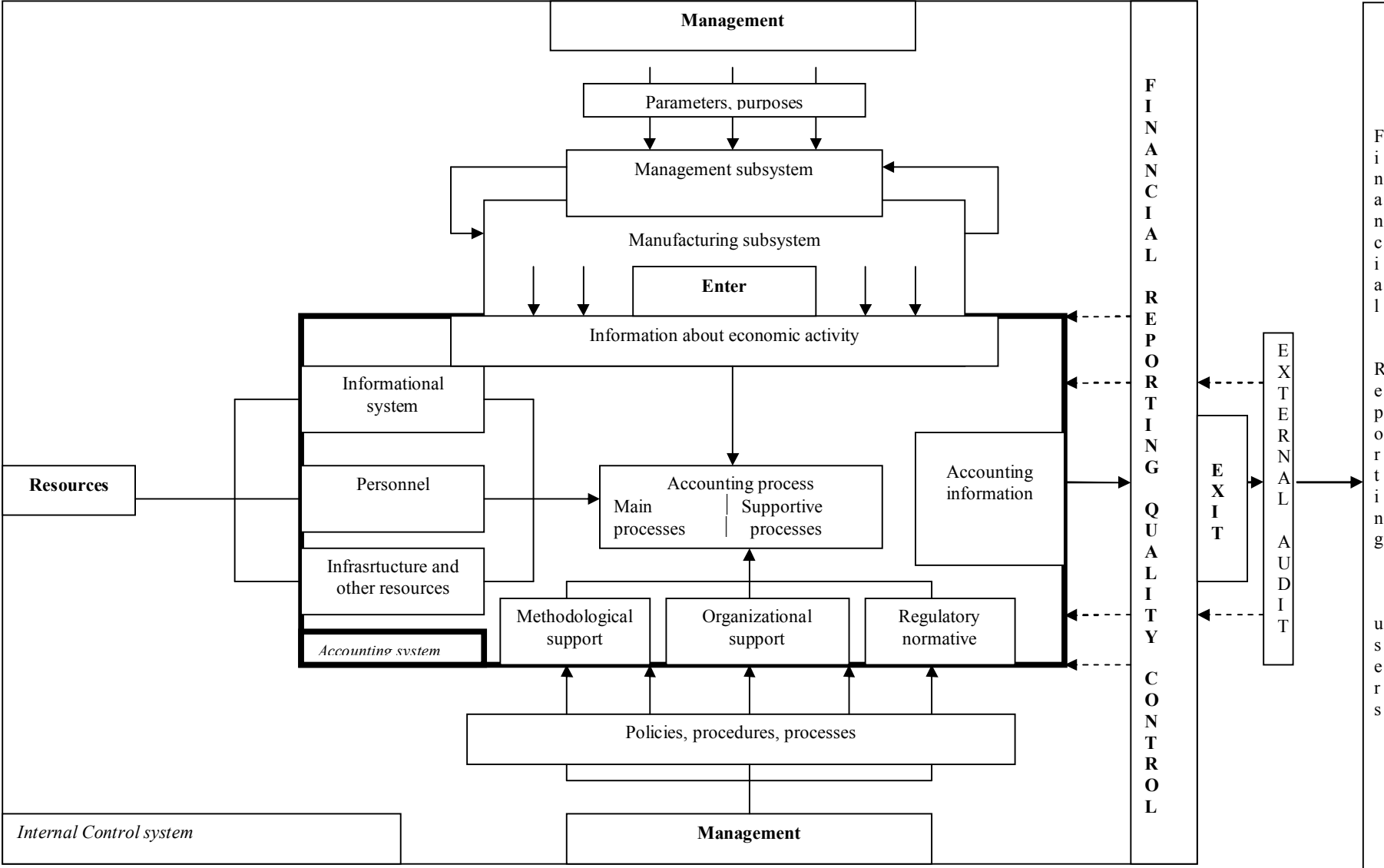
В.Т. Рычков

Appendix 3

Accounting types differences

	Tax accounting	Financial accounting	Managerial accounting
Legislative base	Tax legislation	Legislation in the sphere of accounting, standards and positions	Economical practicality
Purpose	To advance the size of the taxable base, to make payments in the budget and off-budget funds and to hand over tax returns	To create the ordered system of the collection, registration and information generalisation in money terms about property, obligations of the organisation and their movement by the continuous and documentary accounting of all economic operations and to hand over accounting reports.	To simplify planning and the control
Main object of analysis	Company and its structural departments	Entity as a whole	Structural departments, products, projects and etc.
Obigatory	Obligatory	Obligatory	Non-obligatory
Main users	Chiefs, tax institutions	Chiefs, statistical, tax and other state institutions and persons	Chiefs, all interested departments and employees
Theoretical base	Normative acts	Normative acts	Microeconomics, decision-making
Data reception methods	Data of documents integration	Universal enumeration, continuous registration	Definition of a course and results of activity in the past, the present and the future depending on a problem.
Types of accounting system	Is not limited by the double entry system	Double-entry system	Is not limited by double-entry system
Measures	Money and natural measures	Money measures	Any suitable monetary or physical a unit measurement
Cost grouping	-	By elements	By calculation
Narrative form	Tax return	Defined accounting reports	The budgets, the reports on price range, the sales, special analytical reports
Report periodicity	Periodically on a regular basis, and also at the moment of occurrence of tax obligations and privileges	Periodically on a regular basis	When is neede
Business period	Annual, quarter, monthly	Mostly quarter	Any period, depends on a problem
Main characteristic	Accuracy	Accuracy	Relevancy
Degree of reliability	Depends on the purpose of taxation	Orientation on the past control	Orientation on the future
Freedom of choice	Obligatory following of tax legislation	Obligatory GAAP or other standards and position	Without any limits

Appendix 4



The financial reporting quality control in the structure of an enterprise