Technique for Internal Control of Company’s Equity

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Abstract. The article is aimed at developing the methodology of internal control of equity, considered from the standpoint of accounting and economic approaches through the development of a descriptive structural and logical model of internal control, taking into account the characteristics of equity. In order to achieve this goal, it is necessary: first, to determine the features of equity capital as an object of internal control from the standpoint of accounting and economic approaches; second, to develop and justify a descriptive structural and logical model of internal control of equity. Technique for Internal Control of Company’s Equity is designed through the development of a structural and logical model that takes into account the peculiarities of equity capital and considers it from the standpoint of both accounting and economic approaches based on accounting software. The results of the study can be implemented in the formation of an internal control system focused on creating value in commercial organizations. In particular, the developed structural and logical model allows us to systematize and improve such types of support within the internal control system as: regulatory, conceptual, organizational and methodological, information, technological, which contributes to a systematic approach to conducting internal control of equity and creates a basis for the development of its methods in the conditions of digital transformation and uncertainty of the external environment.

Keywords: Internal control · Equity · Accounting approach · Economic approach

1 Introduction

In the modern economic literature devoted to the issues of internal control and audit, due attention is not paid to such an object of accounting as equity capital. The questions connected with the accounting and carrying out of audit of own capital, are disclosed in the works of such scientists as Abeysekera [1], I. A., Alekseeva I. V. [2], Betge Y., Bogataya I. N. [3], Beschetnaya S. V., Van Breda M. F., Evstafieva E. M. [4], Kalyugina I. V. [5], Kyshtymova E. P. [6], Novodvorsky V. D. [7].

These researchers focused more on the methodology of accounting and auditing, as well as the implementation of audit procedures in relation to equity and its individual
components. From the perspective of the COSO concept, they comprehensively considered issues related to the assessment of the internal control system in relation to equity. However, approaches to the specifics of internal control of equity capital have not been developed.

The mentioned researchers to a greater extent concentrated their attention on the methodology of accounting and auditing, as well as implementation of auditing procedures in relation to equity and its separate components. From the position of COSO concept they have extensively considered the issues related to the assessment of the internal control system in relation to the equity. However, no approaches to the specifics of internal control of equity have been developed.

In view of the fact that preservation and increase of the value is the most important strategic task of business organizations, the issues should be considered from the position of organization of internal control of the value creation process within the framework of five basic elements of internal control system. Thus to the questions of internal control of own capital, in our opinion, it is necessary to approach comprehensively that assumes realization not only of accounting approach to understanding of own capital, but also its consideration from position of economic approach. It assumes consideration of own capital not only as cost of its assets minus liabilities (cost of net assets), but also as set of means of the organization which are in its ownership, represented from a position of the concept of plurality of the capital by its various kinds (financial, industrial, intellectual, human, social and reputation, natural, etc.) that corresponds to the economic approach.

From the perspective of the conceptual framework of internal control as well as the conceptual framework of enterprise risk management (COSO ERM), strategy plays an important role in the process of value creation in business organizations. For the successful implementation of a strategy aimed at value creation, it is important to take into account the peculiarities characteristic of capital. These peculiarities should be taken into account within the framework of the internal control system. Key features of the own capital are: client orientation, circulation of the capital, use of a wide spectrum of estimations of the own capital and methodical approaches within the limits of various kinds of the accounting, self-growth of cost, social orientation, features of the own capital caused by organizational and legal form of an economic entity; plurality of types of the own capital.

2 Improved Technique for Internal Control of Company’s Equity

In the course of research, we developed a structural and logical model of organization and implementation of internal control of equity capital, presented in Fig. 1, which involves consideration of equity capital both from the perspective of accounting and economic approach and taking into account the features characteristic of equity capital in conditions of digital transformation.

The rationale for the logic of the organization and implementation of internal control of equity capital was carried out on the basis of highlighting the different types of collateral used, such as: 1) regulatory and legal; 2) conceptual 3) organizational and methodological; 4) informational; 4) technological.

The basis for organization and realization of internal control of the equity capital is the regulatory and legal support.
Aggregately, the regulatory framework includes acts in the field of:

1) internal control (international (COSO, COSO ERM), national and local or internal);  
2) accounting and formation of non-financial reporting (IFRS, ISIR, Russian legislative, regulatory, methodological and organizational acts).

As a feature of the regulatory framework should be noted its focus on international standards and guidelines in the field of accounting, internal control. Besides, approaches to accounting and control provision formation, connected with inclusion of aspects traditionally characteristic for economic approach, connected with risk estimation, search of internal production reserves, strategy of organization, planning of activity, organizational culture and ethical values of organization have considerably expanded. It is necessary to note the general tendency connected with the convergence of the Russian normative base with the international one. The large number of standards of international standards also draws attention, for example, devoted to the evaluation of risks in an organization and the formation of non-financial information.

Conceptual support of internal control of equity capital includes fundamental concepts, as well as general scientific (induction and deduction, analysis and synthesis, modeling, analogy, etc.) and specific methods related to the specifics of equity capital, considered from the standpoint of accounting and economic approaches. The basic principles and methods within the aforementioned approaches may differ significantly. If the accounting approach to a greater extent is aimed at compliance with the requirements of the current legislation and reliability of reporting, within the framework of the economic approach the issues related to efficiency of use of equity capital, process of value creation and use of various types of capital (financial, intellectual, financial, etc.) are in the foreground.

Organizational and methodological support is based on the Conceptual Framework of Internal Control COSO and other acts included in the regulatory framework governing the organization of internal control.

The peculiarity of information support is the use of both external and internal information. At the same time, external sources become important, which is due to expansion of practice of formation of estimated values in the Russian accounting and requires systematic collection of information on them and their periodic review.

Technological support for internal control of equity capital under conditions of digital transformation includes a wide range of software products and services based on the use of digital technologies:

- legal reference systems;
- service programs and services (e.g., the Transparent Business service of the Federal Tax Service, etc.).
- accounting automation programs that involve the use of digital technology;
- engineering programs for management of accounting, control and audit, analytical and strategic processes, including those integrated with external environment sources and involving the use of digital technologies;
- specialized and auxiliary programs, services for control and risk assessment.
1. Regulatory and legal support

Regulatory and legal acts in the field of:
1) internal control;
2) accounting of equity capital and formation of non-financial reporting.

2. Conceptual support

1) Concepts of equity
2) General scientific methods
3) Specific methods and techniques of internal control information.

3. Organizational and methodological support

Organization of internal control of the IC

1. Control environment
2. Risk assessment
3. Information and communications
4. Control actions
5. Monitoring of controls

Evaluation of ICS EC (ICS testing methods)

Recommendations for improving the ICS EC

The general scheme of internal control of internal control of the IC:
1. definition of the goal of internal control of the IC;
Determination of normative acts and internal regulations, on the basis of which the internal control of the IC is carried out;
Determination of the tasks of the IC's internal control;
4. determining the sources of information, used in the course of internal control;
5. The choice and realization of the internal control methodology;
6. Detection of violations of legal requirements or internal regulations, inefficient use of the IC.
7. Analysis of factors affecting the IC, search for reserves to improve the IC use efficiency on the basis of information obtained from the results of control actions and development of recommendations for the implementation of the identified reserves.

Fig. 1. Descriptive structural-logical scheme of organization and implementation of internal control of equity capital of commercial organizations
The dynamic development of software and hardware support for internal control is connected with the processes of digital transformation, the use of blockchain technologies, the introduction of international and Russian standards in the field of risk assessment and management.

3 Peculiarities of Organizational and Methodological Support of the Internal Control of Equity Capital

The organization and realization of equity’s internal control includes 5 basic components. The first component of the system of internal control - the control environment represents the basis of this system and is directly connected with strategy of the organization. The strategy of the commercial organization, as a rule, is aimed at creation of value and is concretized in the strategies of lower hierarchical levels assuming management of various kinds of capitals (financial, industrial, intellectual, human, social and reputation, natural, etc.). Creation of value is possible only when strategies will be focused on creation of value for clients, realization of effective personnel policy assuming rational use of human and intellectual capital, receipt of profit by investors.

Creating value is impossible without creating and maintaining a culture of integrity and ethical behavior in a commercial organization by top management. Table 1 shows the analysis of the influence of the main elements of the control environment on equity capital.

Value creation is directly linked to risk assessment, which is the second component of the internal control system. In this regard, it is necessary to assess the risks associated with the decline in the value of equity. In our opinion, at the first stage it is advisable to conduct a PEST-analysis, which allows to identify external and internal factors that have a significant impact on the organization, as well as SWOT-analysis, which allows to identify weaknesses and strengths of the organization, as well as opportunities and threats. In addition, it is necessary to form a register of risks, assess their significance, probability of occurrence and make decisions on their minimization to the level of risk appetite. It is important to identify the risks that make it difficult to achieve the strategy aimed at creating value. Thus risks can be connected not only with distortions of various kinds of reporting, but also inefficient use of various kinds of capital that, eventually, will lead to decrease in value of net assets of the commercial organization.

The identification and assessment of risks of material misstatement in accordance with ISA should be conducted at the level of:

1) financial statements, but this approach is also applicable to other types of reporting (e.g., management reporting);
2) Assumptions regarding the types of transactions, account balances and disclosures that are important to external users of statements (primarily investors).

Particular attention should be paid to assessing the risk of dishonest actions, as well as the risks that lead to the inefficient use of various types of capital, which almost always has a negative impact on the value creation process. Since the external and internal environment of an organization is volatile, it is necessary to periodically review the risks. In
Table 1. Analysis of the influence of the main elements of the control environment for capital

| Elements of the control environment | Interpretation of equity | Capital as the totality of funds of an organization owned or controlled by it (economic approach) |
|-------------------------------------|--------------------------|------------------------------------------------------------------------------------------------|
| Equity as the total value of its assets less liabilities (net asset value (accounting approach)) | Compliance with ethical principles contributes to value growth | The risk of unfair practices, inefficient use of various types of capital is reduced |
| Communicating the principle of integrity and ethical values to employees | It promotes value growth through sound management decisions | It reduces the likelihood of inefficient management decisions on the use of different types of capital |
| Commitment to competence | It increases interest, objectivity of control over the value creation process at its various stages | It reduces the likelihood of inefficient management decisions on the use of various types of capital |
| Participation of persons responsible for corporate governance | Assumes the development of the organization’s strategy aimed at increasing the value with a focus on customers, the profit of investors | Assumes, as part of the organization’s strategy aimed at increasing the value, to have a strategy for using different types of capital, primarily human, intellectual |
| Philosophy and management style of leadership | The efficient organizational structure makes it possible to trace the process of value creation by responsibility centers | The effective organizational structure makes it possible to trace the processes of using different types of capital and evaluate their effectiveness |
| Organizational structure | It reduces the risks of dishonest actions | It reduces the risks of unfair actions in relation to the use of different types of capital, promotes the rational use of human and intellectual capital |
| Distribution of authority and responsibility | The effective human resources policy opens up new opportunities with respect to the growth of equity capital based on intellectual capital | The effective human resources policies and practices promote the rational use of almost all types of capital, especially human, intellectual capital |

Source: Compiled by the author on the basis of [8].
the COVID-19 pandemic, risk review is mandatory in the internal control assessment. Such revision should be based on the analysis of information from external sources (industry and economic journals, information from mass media, analytical reports, statistical data, etc.) and internal sources represented by the forms of management reporting used in a commercial organization. Both financial and non-financial information is used. Risk assessment involves the use of data, both financial and non-financial reporting for past periods, and forecasting information.

As part of the third component of the internal control system - information and communications, it is necessary to organize an accounting system aimed not only at compliance with current legislation, the formation of reliable financial reporting, but also at the development and improvement of management accounting methods, as well as the formation of non-financial and management reporting, allowing the disclosure of information about the value creation process. This will require: firstly, the definition of economic transactions in the greatest degree, influencing the growth of the value, secondly, the use of information technologies, thirdly, developed communications in terms of interaction with management and those responsible for corporate governance in making management decisions aimed at increasing the value and the presence of feedback.

Informing in the commercial organization can be carried out on the basis of system of the internal regulations concerning policies in the field of internal control, risk management, formation of various types of the reporting, etc.

It should be taken into account that the selected elements of accounting policy for accounting (financial) purposes may lead to information asymmetry and financial accounting data may require adjustments to make management decisions aimed at creating value. In organizations that form the accounting policy for accounting (management) purposes, the elements of this policy are aimed at the formation of relevant information. Changes in accounting policies should be reflected in the financial statements retrospectively, with the exception of those organizations that use simplified methods of accounting.

The information system associated with various types of reporting, formed in a commercial organization, involves initiating, recording, processing and summarizing the organization’s operations (as well as events and conditions), ensuring accounting of relevant assets, liabilities and equity; timely correction of identified errors; fixing the facts of bypassing controls; transferring information from transaction processing systems to the main register; recording information that is significant for the reflection in the reporting, ensuring the collection, recording, processing At the moment Russia widely uses cloud accounting based on SaaS concept (1C: Accounting, Info-Predpinitelstvo, Buchsoft “Moye Delo”, Kontur, Nebo, etc.), as well as mobile accounting applications. And mobile accounting applications (e.g., Regulatory, Invoicing, Mobile Bank, etc.), which, on the one hand, requires the digital skills of personnel, and, on the other hand, increased attention to cybersecurity and digital trust.

The fourth element of the internal control system - control actions - should be built with focus on prerequisites of reporting, both financial and managerial.

The main areas of validation of reporting prerequisites with respect to equity are presented in Table 2.
Table 2. Main directions of confirmation of the prerequisites of reporting on equity capital

| Prerequisites                                      | Capital as net asset value (NAV)<sup>a</sup>                                                                 | Capital as the sum of capitals                                                                 |
|---------------------------------------------------|-------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------|
| Assumptions about the types of transactions and   | FEA related to equity disclosed in different types of statements are relevant to the organization          | FEA related to different types of capital disclosed in different types of reporting are relevant to the organization |
| events, as well as the appropriate disclosures for the audited period |                                                                                                               |                                                                                                  |
| Availability                                      | FEA related to equity as disclosed in different types of statements are reported comprehensively               | FEA related to different types of capital disclosed in different types of statements are reflected comprehensively |
| Completeness                                      | FEA related to equity disclosed in different types of statements are correctly evaluated and described         | FEA related to various types of capital disclosed in various types of statements are correctly evaluated and described |
| Accuracy                                          | FEA related to equity disclosed in different types of statements are reflected in the proper reporting period  | FEA related to different types of equity disclosed in different types of statements are reflected in the proper reporting period |
| Timeliness of recognition                         | FEA related to equity, disclosed in different types of statements, are reflected in the appropriate accounts   | FEA related to different types of capital disclosed in different types of statements are reflected in the appropriate accounts |
| Classification                                    | FEA related to equity disclosed in the various types of statements are properly grouped or disaggregated and clearly described, and the related disclosures are relevant and understandable in the context of the requirements of the applicable financial reporting framework | FEA related to the various types of capital disclosed in the various types of statements are properly grouped or disaggregated and clearly described, and the related disclosures are appropriate and understandable in the context of the requirements of the applicable financial reporting framework |

Assumptions about account balances and related disclosures at the end of the period:

(continued)
**Table 2. (continued)**

| Prerequisites                | Capital as net asset value (NAV)<sup>a</sup> | Capital as the sum of capitals |
|-----------------------------|---------------------------------------------|--------------------------------|
| **Existence**               | Assets, liabilities related to equity do exist | Assets, liabilities related to various types of capital do exist; |
| **Rights and obligations**  | The organization owns or controls the rights to the assets, and the liabilities represent the legal obligations of the organization; | The organization owns or controls the rights to the assets, and the liabilities represent the legal obligations of the organization; |
| **Completeness**            | All assets, liabilities and equity interests required to be recorded have been accounted for and all relevant disclosures required to be included in the financial statements have been included | All assets, liabilities and equity interests required to be required to be recorded have been recorded and all relevant disclosures required to be included in the financial statements have been included |
| **Accuracy, measurement, and allocation** | Assets, liabilities, and equity interests are included in the financial statements at appropriate amounts, all appropriate measurement or allocation adjustments are properly recorded, and appropriate disclosures are properly valued or described | Assets, liabilities and equity interests are included in the financial statements in the appropriate amounts, all appropriate measurement or allocation adjustments are properly recorded, and related disclosures are properly evaluated or described |
| **Classification**          | Assets, liabilities, and equity interests are recorded in the appropriate accounts | Assets, liabilities, and equity interests are recorded in the appropriate accounts |
| **Submission**              | Assets, liabilities and equity interests are appropriately grouped or disaggregated and unambiguously described, and the related disclosures are appropriate and understandable within the context of the applicable financial reporting framework | Assets, liabilities and equity interests are appropriately grouped or disaggregated and unambiguously described, and the related disclosures are appropriate and understandable within the context of the applicable financial reporting framework |

<sup>a</sup>the fact of economic activity (FEA).

Source: Compiled by the author on the basis of [8]

The main types of control actions and their impact on equity, considered from the standpoint of accounting and economic approaches, are presented in Table 3.
Table 3. The main control actions and their focus on equity capital, considered from the standpoint of accounting and economic approaches.

| The aggregate areas of control actions highlighted in ISA 315 | A focus on capital as a NAV | The sum of the different capitals |
|-------------------------------------------------------------|-----------------------------|----------------------------------|
| Performance reviews                                         | Analysis of the value creation process | Analysis of the use of different types of capital |
| Information processing                                      | Accuracy control calculations | Accuracy control calculations |
| Physical controls                                           | Detect or prevent the diversion of assets and subsequent NAV reduction | Aimed at preventing asset theft |
| Segregation of duties                                       | Prevent bad faith actions leading to NAV depreciation | Legality of transactions with different types of capital |

The fifth element of the internal control system - monitoring of controls - allows to evaluate the effectiveness of control procedures used in relation to equity, considered from the standpoint of accounting and economic approaches, as well as to develop recommendations for their improvement.

Internal auditors, and in small and medium-sized businesses, employees performing similar functions, perform the functions of monitoring the means of control of the organization, based on both internal and external information, assess the effectiveness of the internal control and make recommendations for its improvement [8, 9].

Methodological support of internal control over own capital is a set of methods and techniques used both at the organization of internal control and at implementation of control actions.

It is possible to distinguish a group of methods aimed at internal control evaluation in relation to own capital, which is considered from the standpoint of accounting and economic approaches, and a group of methods of control actions inspection, aimed at receiving information about compliance with applicable legislation and regulations, reliability of different types of reports, which disclose information about own capital and main types of capital, evaluation of efficiency of own capital use and value creation process, as well as about the effectiveness of the control actions.

These groups of techniques can be used by internal control and internal audit services of large organizations, external auditors and consultants, audit commission.

The first group of techniques can be implemented on the basis of internal control testing in respect of equity capital.

The second group of techniques is focused on classical external audit procedures, as well as operational audit of the equity. At the same time, within the framework of this technique it is necessary to:
1. to determine the internal control objectives (for example, compliance with the requirements of the current legislation, search for reserves with regard to the use of equity capital, etc.);
2. to determine the normative acts and internal regulations, on the basis of which the internal control of the internal control is carried out, as they may significantly differ depending on the purpose of such control;
3. to define the tasks within the scope of the set goal;
4. to define the sources of information used during the internal control;
5. To make a choice and implement the internal control methodology;
6. To reveal violations of legal requirements or internal regulations, inefficient use of various types of capital.
7. To analyze the factors influencing the own capital, to search for reserves to increase the efficiency of use of the internal control and various types of capital on the basis of the information received by results of performance of control actions and to work out recommendations on implementation of the revealed reserves.

4 Conclusion

Therefore, in the course of research the descriptive structural and logical model of the organization and implementation of internal control of equity capital in the commercial organization, which includes the following types of support: regulatory, conceptual, organizational and methodological, informational and technological support on the basis of digital technologies was formed. This model reveals the general scheme of internal control of IC considered both from the position of accounting and from the position of economic approach. This scheme includes: 1. Determination of the aim of the internal control of the IC; 2. Determination of the statutory acts and internal regulations, on the basis of which the internal control of the IC is realized; 3. Determination of the tasks of the internal control of the IC; 4. Determination of the information sources, used during the internal control; 5. Selection and realization of the internal control methods; 6. Detection of violations of the legislation or internal regulations. 7. Analysis of factors influencing the shareholders’ equity, search of reserves to increase the efficiency of SK and various kinds of capital on the basis of information received by the results of control operations, and working out recommendations on implementation of the reserves revealed, which will allow to estimate the legality of operations with the shareholders’ equity, reliability of financial and non-financial information, and increase the efficiency of SK and value creation process in a commercial organization.

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