

## Mechanisms of monitoring systems influence on work efficiency of financial undertakings

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**Abstract.** Results of theoretical and methodological foundations of internal control system creation analysis in financial undertakings and their real condition estimates in Kazakhstan are represented in an entry. On the basis of factor analysis, factors and conditions of internal control systems organization, which mostly influence the work efficiency of financial undertakings, are dedicated. Empirical data show, that work efficiency of financial undertakings functioning mostly depends on organization correctness of internal control systems, and transaction risks control as well. Recommendations on control systems in financial undertakings for improvement of their work efficiency are set forward.

[Mirzhakypova S.T., Nurgaliyeva A.M., Bikteubayeva A.S., Assanova A.B., Mynbaeva D.Ye. **Mechanisms of monitoring systems influence on work efficiency of financial undertakings.** *Life Sci J* 2014;11(12s):478-482] (ISSN:1097-8135). <http://www.lifesciencesite.com>. 103

**Keywords:** internal control, internal control procedures, financial undertakings work efficiency

### Introduction

An adequate organization of internal control system in financial undertakings is extremely actual, especially in the context of persisting World financial crisis adverse trends. This problem is of importance not for Kazakhstan and CIS countries only, but and for economically developed countries also [1-3].

The main objective of the internal control is investor's and financial organizations' clients interests protection by supervision of their compliance by national legislation and corporate practices employees, all parties' interests observance, an adequate security level procurement, which corresponds a character and a scope of operations, executing by financial organization and risk management of investment and financing activities.

### Theory and methodology

**Question theory.** Up until recently in the world existed various construction concepts of financial undertakings internal control systems, which reflected their functional peculiarities (banks, investment funds, insurance companies etc.) and country-type differences as well [4-11]. At the present moment these concepts are getting closer to each other in view of business transnationalization growth, general laws of financial undertakings operating performance, globalization growth of economic and financial systems, drawing together of financial undertakings general conditions, independently of their ethnical identity.

### Research methodology

The research is based on methods of comparison study, current situation, regulatory documents. Comparison analysis method was used for regulation comparison of internal control

improvement and establishment of statutory documents in financial undertakings of Kazakhstan and internal supervision as well, Basel Committee for Banking Supervision, in particular, «Core Principles for Effective Banking Supervision», «Enhancing corporate governance for banking organizations», «Enhancing Bank Transparency», inter alia. [12-14].

Statutory documents on internal control management in banks, worked out by National Bank of Republic of Kazakhstan were used [15]; Committee of Regulatory Activity and Financial Market and Undertakings Monitoring of Republic of Kazakhstan [16], statutory documents on internal monitoring organization in commercial banks, pension funds, investment funds, insurance undertakings of Kazakhstan, test and evaluation of internal monitoring establishment procedure, developed for auditing and estimation of internal monitoring, developed by National Bank for Credit Institutions [17].

### Research

Empirical data show, that performance of financial undertakings mostly depends on establishment accuracy of their activities internal supervision system, risks managerial efficiency first of all. With this, under **financial undertaking internal monitoring system** we shall mean internal monitoring procedures and policies array, which provide long-term objectives of profit margin and support of its reliable financial and management statements system achievement, assisting statutory compliance of its own country and international rules observance, corresponding financial undertaking policy, internal rules and activity procedures in purposes of costs risk decrease or current financial undertaking reputation loss.

A certain order of internal monitoring systems creation for financial undertakings of different types is stated by national statutory documents in corresponding areas. Let's name the basic:

In the authority of *banking activity*: Decision of the Agency Administration on Financial Market and Organizations Regulatory Activity and supervision of Kazakhstan Republic of 30.09.2005 #359 "Approval of Instruction on Requirements to the Availability of Risks Management Systems and internal Monitoring" in second-tier Banks and alterations in Decision of the Agency Administration on Financial Market and Organizations Regulatory Activity and Supervision of Kazakhstan Republic of 26.03.2005 #116 "On Introducing Amendments in some Regulatory Legal Acts on points of Regulatory Activities and Surveillance of Financial Market and Organizations".

Activity of *pension funds*: Statute of the Bank of Republic of Kazakhstan "Employee Retirement Income Security Act in Republic of Kazakhstan" of 21.06.2013 105-V Statute Law of Republic of Kazakhstan (Section 52. Risks Control and Internal Monitoring System); Decision of Administration of The National Bank of Kazakhstan Republic of 27.08.2013 #240 "Approval of Risks Management System and Internal Monitoring for Unified Pension Savings Fund and Willful Savings Funds";

Activity of *investment funds, other financial undertakings in equity market*: Statute of the Bank of Republic of Kazakhstan of 21.04.2003 #137 "Approval of Regulation on Carrying out portfolio management activity"; Decision of the Agency Administration on Financial Market and Organizations Regulatory Activity and supervision of Kazakhstan Republic of 26.09.2009 #209 "Approval of Instruction on Requirements System of Risk Management on existence of risk management system for providers of brokerage and dealer activities at the entity market, portfolio management activity";

*activity of microlenders*: Statute of Kazakhstan Republic "Law on Microlenders" of 06.03.2003 #392 (Section 13. Internal Control Service);

5) *activity of insurance companies*: Decision of the Agency Administration on Financial Market and Organizations Regulatory Activity and Supervision of Kazakhstan Republic on Financial Market and Organizations Regulatory Activity and Supervision of Kazakhstan Republic "On Requirements Determination to Existence of Risk Management in Insurance (Reinsurance) Companies" of 30.04.2007 #130; Decision of the Agency

Administration on Financial Market and Organizations Regulatory Activity and Supervision of Kazakhstan Republic of 24.02.2012 #99 "Requirements to Risk Management System and Internal Monitoring of Insurance Group".

It ought to be noted, that new regulations "On Risks Management System and Internal Control for Second-tier Banks", concerning internal monitoring in second-tier banks by the Decision of Administration of Nation Bank of Republic of Kazakhstan of 26.01.2014 #29, which get into force since January, 1 2015 are confirmed.

Benchmarking assessment of the international and nation statutory documents in the area of internal monitoring in various financial undertakings (commercial banks, investment funds, insurance (reinsurance) companies, microcreditors) showed that accurately acting internal control system should include a range of obligatory components. They are:

- Control environment
- Regulatory activity
- Control activity
- Monitoring

An accurate definition of a *control environment* makes up a basis for efficient realization of all internal control components. Regulations, powers and duties dividing, the choice of the instruments of control, control activity itself fulfillment, normative standards and control lead time, general performance indicators etc. establishment are defined by the elements of control environment. They may differ in various financial institutions, but in all financial undertakings, without exception, the most important object of control are risks (operation, credit, investment, currency etc., and the priority in the choice of a risk depends on the type of financial undertaking). Also, the borders defining and control environment scope are defined by the following factors such as: headquarters policy and methods of financial undertaking management; structure of organization; practice activity of headquarters and management and responsibility functions assignment.

*Regulatory activity* represents a system of statutory documents, dispositive financial undertaking activity, its departments and employees. Regulatory activity includes formulation, acceptance and observance of statutory document complex:

External (list of binding instruments, extended by a borrower for obtaining a credit, an insurance etc., for example);

Internal (different types of manuals, instructions, statutes, regulations etc., for example).

The importance of correctly arranged regulation is very high, as far as it affords to improve

efficiency and reduce a risk of many transactions, performing by financial undertakings even at the outset of transaction performing as well as transaction passing by stages.

*Control activity* is the main element of internal control system. This is a process of communication and functioning of separate system elements of internal control. It includes standard (control functions fulfillment during their own duties of employees fulfillment) and special control procedures as well.

Control procedures are methods and rules, refilling the elements of control environment, established by administration to achieve goals, which are set to a financial undertaking. Control procedures are targeted on prevention, disclosing and rectifying of errors and disfigurements, which may arise with transaction performing. *Special control* is a department activity (internal audit department) or the individual transactions and department and subdivision activity results checking personnel as on a regular basis and one-time basis as well. *An operational audit* takes place in the course of check-out current transactions, including regular administrative managerial activity, daily personnel activities on their everyday duties fulfillment.

*Monitoring of internal control system* includes monitoring of internal control system in aims of failure detection in its functioning, degree of compliance to the aims of financial undertaking activity estimation, proposal development and monitoring for decision implementation on its improvement, on a regular basis. Internal control system monitoring is implemented by headquarters of financial undertaking and employees of different subdivisions, general financial transactions and other dealership implementation, their view in books and the booking records and check-out by internal control service as well.

This way, to estimate the quality of work of internal control system in financial undertakings and its influence on activity efficiency of a concrete financial undertaking, we should indicate availability, organization quality, efficiency of communication of many compulsory elements of internal control system.

### Results of research

Results of quality analysis of internal control system organization of financial undertakings of Republic of Kazakhstan showed, that in many of them absent an adequate organization of internal control system, that obstructs the efficiency of their functioning. In particular, recently a fast growth of loss loans in Republic of Kazakhstan is the evidence

of badly functioning system of banks internal control over the loan risks [18].

The analogue situation exists with insurance organizations of Kazakhstan, which claim reformation. According to the estimates of headquarters of leading insurance companies of Kazakhstan, some aspects of their activity are still unadapted to modern realms [19]. Taking into account, that on the part of supervisors of Republic of Kazakhstan a stiffing of regulatory requirements to insurance companies is approaching, we may suppose, that in the process of further mergers and acquisitions of weak players by strong ones, in frames of acquisitions it will be possible to get a reliable internal control over risks and general transactions on the right track, that increases the efficiency of Republic's insurance companies functioning in general.

In judgments of many experts, critical situation in area of transaction control have financial undertakings, acting at the entity market of Kazakhstan, investment funds, second tier banks, undertaking broker and dealer activities at the entity market, activities of portfolio management and etc. inter alia.

In general, characteristic of entity market condition of Kazakhstan is given as "completely deadlocked" [20]. The situation is harder with microfinancing organizations, concerning which the external control is significantly lower and risks are significantly higher.

The analysis showed, that in many financial institutions of Kazakhstan, effective internal control systems are absent. Mostly, it consists in following:

- an adequate financial control system absence, on distorted resource allocation and loan repayment first of all;

- management inefficiency of financial undertaking in general;

- lack of straight and full of internal regulatory and legal framework of financial undertaking;

- internal control structure, which affords in many financial undertakings the lack of functional focus;

- an absence of formalized list of organization employees circle, fulfilling function control of their duties;

- existence of doubling and parallelism in the activity of internal audit bodies, etc.

- absence of clear understanding, accepting and, mainly the fulfillment by personnel of internal audit procedures, developed by administration of financial undertaking;

- enough time absence for managers for fulfillment of audit operations of ongoing monitoring

and in time drawbacks detection by employees of the company;

absence of reliable audit over fulfillment of regulatory risks standards, established by supervisors;

absence of an adequate information system for audit fulfillment;

prevailing of the aim of extra profit getting over the task of financial and economical safety and risks reduction etc.

### Conclusions

With the aim of creation of effectively functioning mechanism of internal audit of financial undertakings, it is necessary to create and improve the following compulsory elements of internal audit system.

Job descriptions, comprised in details, must be worked out, effectively connected and rigorously fulfilled, which must contain:

documentary fixed circle of company's employees, who fulfill functions of planning, organizing, regulating in frames of audit, registration and analysis of fulfillment efficiency of general indexes of financial undertaking activity, legality and efficiency of concrete financial and economical transactions implementation;

an order of worker activities in audit bodies should be established, an order of their actions and communication with all structure subdivisions of financial undertaking, other employees, supervisors, environment structures.

In accordance with regulations for internal audit, a circle of primary documents or other data storage devices should be established, which reported data, testifying of each employee its functions fulfillment; the degree of realization of each stage of financial and business transactions; identified order of documents flow or other data storage devices from the moment of their appearing to the moment of their archivation.

In statutory documents the control points should be clearly identified (audit dates, assigned persons, stages of operation transiting) of estimation of various aspects of realization of concrete financial and business transactions (implementation timelines, statutory documents correspondence, intermediate effectiveness etc.).

Control points of company resources condition estimation should be fixed (their availability, control figures and regulations correspondence (for example, economic security ratio etc.), usage efficiency and so on). Parameters of controlled objects must be laid down; critical points of control should, where exists the highest risk of errors likelihood, distortions and other undesirable phenomena should be pointed out.

Special attention should be payed to the choice of types and methods of audit conducting. Considerably it (the choice) depends on the opportunities of management philosophy and headquarters style of work, accepted in communication organization, first of all, of attitude of leading managers and headquarters, developed in a company, to commercial, financial and intercompany risks; on adequacy of understanding the role of internal audit in efficient company management; of already practicing set of concrete actions on organizing and improvement of audit system.

The important role in building of the efficient internal audit system of any company has the organization form of internal audit department as a special coordination center of responsibility. Exactly on its location, functional authority and the status of finance organizing in company structure mostly depends on getting in time and the quality of obtained audit results.

The efficiency of audit mechanism and audit system is defined by the adequacy of audit devices (that is information computing equipment and technology) and information audit provision of complexity of controlled environment and set tasks of control. The estimation of audit system adequacy supposes fulfillment of all control links (of audit), provision of reasoned proposals concerning corrective actions and recommendations on management efficiency improvement.

On this basis, the estimate of financial undertakings efficiency is provided, variable aspects of company functioning expert estimates are made and reasoned proposals on their improvement are provided, and keeping of the above mentioned requirements, affords provision of main goals of financial structures internal audit systems realization on efficiency of their activity improvement:

resources and facilities of financial undertaking maintaining and efficient usage;

financial undertaking in time adaptation to changes in internal and external environment;

financial structure efficient functioning procurement;

stability and development maximum in conditions of diversified competitions.

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7/13/2014