PRACTICAL ASPECTS OF FINANCIAL CONTROLLING IN A COMPANY

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Abstract: Financial controlling facilitates the managers of companies in making the right managerial decisions. The process of controlling includes planning, control and analysis. Planning is associated with setting goals and developing planned budgets, control – with detecting deviations from the goals, whereas analysis is associated with disclosing the reasons for these deviations. The information system occupies a central place in financial controlling. It includes a system of indicators; the leading indicator being considered as an objective. The role of information systems in controlling is to link planning activities, control and analysis. This article presents the application of the information system of financial controlling in a particular company – an insurance company operating in the sector of General Insurance.

Key words: controlling, financial statements, financial analysis.
JEL: G21, G22.

Different approaches can be used when assessing the financial position of a company. The financial position of a company can be assessed by an external supervisory body such as the Financial Supervision Commission. The assessment is made with the purpose of determining whether the main financial indicators of the company meet the legislative requirements. The assessment of the financial position of a company can also be done by persons directly affected by the company's activities - the shareholders. However, this kind of assessment is rather subjective. It affects the investor's behaviour and gives impetus to taking a decision whether to buy or sell the company's shares. The important condition in this case is that the company is being traded on the stock exchange. An assessment of the company's financial position can also be obtained through financial controlling.

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The role of controlling as a process is to set the goals (laid out in the plan), detect the deviations from the goals (as a result of carrying out control), analyze what causes these deviations and give an impetus to taking a decision how to eliminate them. Controlling in a company includes: planning, implementation of the plan, results reporting, control and analysis (*Kamenov, K., 1993. p. 30*). It is relevant to those who are directly involved in the company's activities (its employees). A subject of controlling is a person inside the company, who uses an information system covering all areas of the company's performance. Therefore, the subject to controlling is production, supply, sales and all other business activities.

The object of study in this article is the financial position of companies in the sector of General Insurance. **The subject** of the survey is the application of a controlling system for reporting the financial state of a company. The thesis of this paper is that financial controlling facilitates the management of the company in taking managerial decisions in order to achieve the pre-set goals.

The purpose of this research is to put into practice the instruments of financial controlling. In order to achieve the set goals, the following **tasks** have been assigned:

➢ to define the objectives of the insurance company in the context of financial controlling;

➢ to present an information system servicing the controlling of an insurance company.

1. Indicators forming the information system in a company

In specialized literature controlling is described as a continuous circular process, which includes planning, control and analysis (*Iliev, B., 2010. p. 195*). By means of controlling it becomes possible to bind planning, control and analysis activities through a comprehensive information system. The role of controlling is not only to detect the deviations of the actual parametres from the planned ones, but also to give an impetus for a change. In this case, it is necessary either to change the standards (with great deviations from them) or to take action which puts the company's performance in line with the pre-set goals. When the pre-set goals have been achieved, the role of controlling is to validate the undertaken actions without having to change the preliminary plans (*Iliev, B., 2010. pp. 194-196*).

The information system that has been used in the process of controlling consists of indicators. These indicators can be both of value and non-value. When Controlling is focused on value indicators, it can be called rigid controlling. When Controlling is focused on indicators of non-monetary value, controlling is called soft controlling. Non-monetary value indicators are: corporate culture, value system and the company's image to the public. These indicators have no value, but directly affect the company's value indicators (*Iliev, B., 2010. pp. 207-225*).

The value indicators, that are included in the company's information system, can be of different nature. Their role is to provide information on the state of the company, parameters of the environment and opportunities for future development of the company under the conditions of changes. Value indicators can be absolute and relative, external and internal, financial and non-financial (*Shulte, C., 1996. pp. 405-409*).

Absolute indicators provide information about the company's performance and environment. These indicators can be divided into financial and non-financial. Financial indicators are shown in the annual financial statements of the company. Financial indicators include: the value of total assets, value of equity, cash flows and cash balance of the company, sales revenue, profit, costs of production and distribution of the product or service, value of investments. Financial indicators provide information about the company's financial position. When financial indicators are at the core of the company's information system, respectively, serve the activities of controlling, then financial control should be mentioned.

Non-financial indicators relate to the number of staff, the number of offices (agencies), the quantity of products sold (e.g. number of insurance contracts concluded by type of insurance). These indicators have a non-financial dimension, but they have a direct impact on the financial position of a company (*Shulte, C., 1996. p. 406*).

Apart from the absolute indicators, a number of relative indicators are also used for the purposes of financial analysis. The relative indicators provide information on the actual state of the company over a certain period.of time. Relative indicators can be divided into two types. The first type of indicators are the ones whose values indicate the relative share of one value compared to the total value. Such structural indicators are: the share of owner's equity in the total capital structure, market share of the insurance company, market share of separate types of insurance products, structural analysis of income and expenditure, analysis of structure of the assets of the insurance company.

The second type of relative indicators are the indicators whose numeric values give information about the spheres of business activity of the insurance company. Such indicators are the following:

- profitability of the premium income – it provides information on the amount of the profit, calculated as profit per BGN 100 premium income;

➢ level of the insurance indemnity – it gives information on the level of insurance indemnities paid per BGN 100 premium income (*Ornelyuk-Malitskaya, L.. et al., 2009. p. 231.*);

➢ return on the investment portfolio – the ratio to the net investment income to the value of the investment portfolio;

➢ return on owner's equity - the ratio of the amount of net profit to the owner's equity;

➢ return on invested capital – the ratio between the amount of operating income (before interest and taxes) and the amount of the invested capital;

➢ relative share of the operating expenses of an insurance company– it provides information on the amount of acquisition costs and administrative expenses per BGN 100 premium income;

➢ share of long-term assets financing by using the owner's equity;

➢ liquidity of an insurance company – the total liquidity as a comparison between the working assets and the current liabilities of the company.

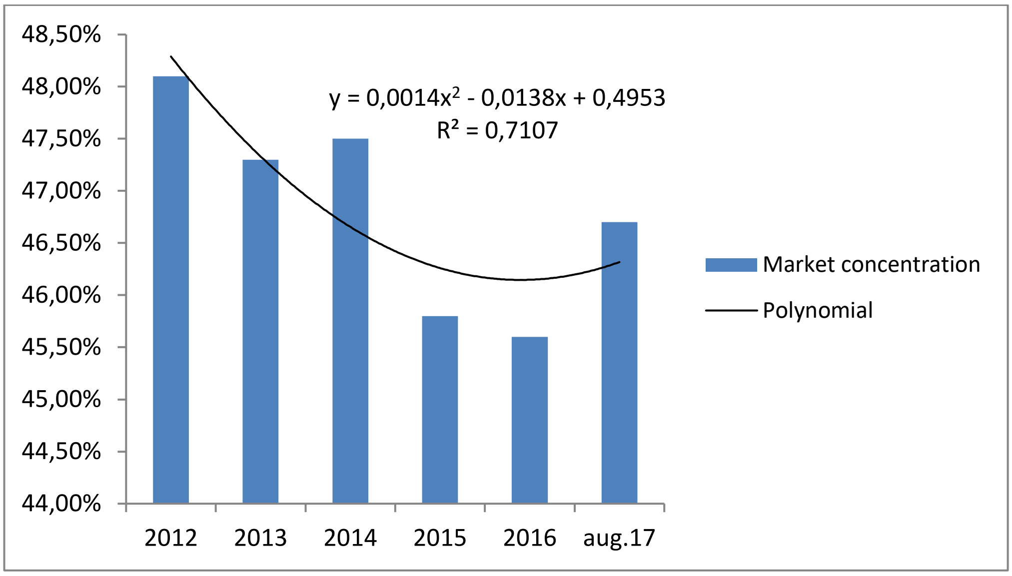
As stated above, what is specific about the indicators of the second type is that they combine values relating to various spheres of business activity of the insurance company. The departments or directorates of a company are responsible for the particular areas of its business activity. In most cases, the analysed indicators provide information on how the insurance companies are generally represented on the market, respectively, on the effectiveness of its operations.

Another criterion, according to which the indicators can be divided for analysis purposes, is the source of the information that is used for their compilation. As far as the company is concerned, these indicators can be divided into external and internal ones. External indicators provide information about the enterprise, such as market environment, competitors in the same area, customers and suppliers. A key indicator providing information on market dynamics and competition is market concentration.

Companies can be ranked, respectively divided into leading companies or not according to different criteria. Such criteria are: the value of the assets, the amount of sales revenue, final financial result reached and profitability of the insurance operations. A leading criterion according to which insurance companies are ranked on the insurance market is the amount of the premium income.[2] The market concentration shows the distribution of premium income among the leading insurance companies and other insurance companies in the sector. When greater part of the premium income is concentrated in the leading four insurance companiese, this means reducing the competition in the

[2] This approach has been adopted by the Financial Supervision Commission.

sector and vice versa – reducing the market share of the leading insurance companies in the sector is a signal for the intensification of competition. Figure 1 shows the market concentration in the General Insurance sector, calculated on the basis of gross premium income generated by the four leading insurance companies.



Author's calculations[3]

Figure 1. Market concentration in the sector of General Insurance

The changes in the market share of the leading insurance companies give information on the economic development of the sector. Market concentration in the 'General Insurance' sector has decreased over the analysed period of time. The trend is for gross premium income to be concentrated not only in leading insurance companies, but also among other competitors in this sector. This indicates intensification of competition among the companies. However, the overall market share of the leading insurers is high, fluctuating between 45 and 48 per cent during the analysed period, which is nearly half of the market share of the General Insurance sector.

Internal indicators are derived on the basis of information about processes within the company. In an insurance company, the information can be of a planned nature, when it comes to calculating the value of the insurance premium, including the tariff for individual types of insurance. The information may also refer to the actual costs, incurred in connection with payment

[3] Data according to the FSC.

of insurance benefits, sales of insurance products, administrative expenses, capital expenditure and financial costs. Internal indicators are relevant to all processes in the insurance company. They should also include gross premium income as a result of the sale of insurance products.

Financial indicators can be divided into external and internal, depending on the entities that use them. External indicators are the indicators which are disclosed in the annual financial statements of the company. In this case, the users are entities external to the company, such as financial control authorities, investors, clients and creditors. As it has already been mentioned above, these indicators give information on the financial position of the enterprise such as financial result, sales revenue and the value of owner's equity.

Internal indicators are those that are derived from the internal accountability of the enterprise. Sources of information that are used are the following: accounting documents, budgets that have been developed, calculation of expenditures by economic elements. The users of the information are persons within the company who perform services to separate structural units of the company. As a general rule, internal indicators are of service to the financial controlling of a company, i.e. they have a direct bearing on the processes of planning, control and analysis. However, Financial Controlling can also be conducted by outsiders, on the basis of information, officially disclosed by the insurance companies, due to the lack of inside information.

Combining the external and internal indicators makes it possible to assess the competitive position of the company on the market. By comparing internal and external indicators the position of an insurance company on the insurance market shall be determined. The comparison of the company's sales revenue with the total premium income in the sector provides information on the market share. A comparison between the specific company's indicators and the average values for the sector provides information on whether the company's performance is higher or lower than the average level for the sector. These indicators are mostly related to financial profitability reporting and economic efficiency of the company in some areas of its business activities. Such indicators are: return on investment portfolio, cost efficiency of insurance products sale, including agency maintenance costs and network of agents, profitability of sales revenue and return on owner's equity.

The advantage of the relative indicators is that they give the opportunity for comparing companies that differ in terms of their value of assets and the amount of sales revenue. Basically, companies with a significantly greater amount of sales revenue also have a higher financial result.[4] Therefore, the

[4] This rule has its exceptions especially in the field of insurance. In modern insurance practice there are cases where companies with times smaller premium income have reached a larger in times financial result.

comparison among companies, based on absolute indicators only, is incorrect. When it comes to comparing companies with different value of assets and different amount of sales revenue, the relative indicators enable that process of fair comparison. This makes it possible to determine the position of a particular insurance company comared to that of its competitors or leading insurers in the sector. The comparison makes it possible to determine whether the company under analysis is ahead or lags behind their competitors in the sector.

The indicators, which have been analysed so far, have to be connected in an information system. In this way, a complete picture of the company's financial position can be obtained, including the processes within the company, the objectives that have been set, the results that have been achieved and the deviations that have occurred. The information system of the company has a direct bearing on its management. The management of the company should be oriented towards the important key financial indicators, which give information on the quality of the assets, the way they are used and their ability to earn certain target yield to their owners. The profitability of sales revenue is also directly related to the yield. Therefore, the operating profit margin should also be an element of the information system that is of service to the controlling in the company. The system of indicators is supposed to give information on the dynamics of the profitability of the insurance company. It should also provide information on the profitability of the business as a whole, as well as the individual agencies, types of insurance products, including the effect of expanding their market share. Expanding the market share of a specific type of insurance is not always a guarantee for a higher financial result that has been achieved by selling it. Consequently, what must be taken into account in this case is the price of the insurance product, as well as the costs related to insurance payments and the sale of a certain type of insurance. The price of insurance product should be adequate to the risk assumed by the insurer. In many cases, the intention of the insurer to increase the market share is related to the insurance cost reduction, which is not always justified. The reduction of insurance costs is related to the risk selection and has a direct bearing on the risk management of the insurance company. The sales expenses, on the other hand, are directly related to the commission fees, which the insurer pays for the upkeep of its agents and agencies. A higher share of commission fees also means a lower premium in favour of the insurance company, which affects underwriting result and the final financial result.

The conclusion, which has been mentioned above, is directly related to the management of the insurance company, its objectives and the strategy it uses to enter the insurance market. Also, an important point in this case is the choice of an insurer as a benchmark, whose key financial indicators should be incorporated as an objective to the management of the insurance company.

This provides the opportunity to compete with companies, which are analogous to the managed company, as well as the leading insurers in the sector.

2. Formulation of objectives in the context of the information system in service of controlling

There is a direct relation between the objectives and the information system of the company. Figure 2 presents the objectives of the insurance company in the context of the financial controlling of the firm (*the scheme is adapted according to Shulte, C., 1996. p. 410*).

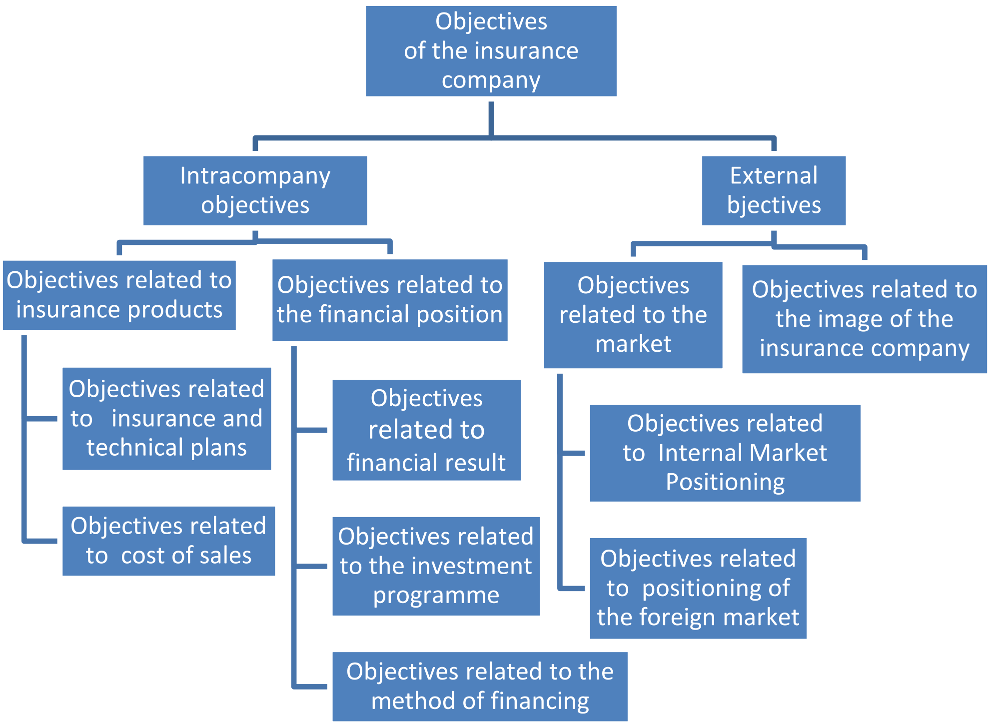


Figure 2. Objectives of the insurance company in the context of financial controlling

The objectives of the insurance company do not differ from those of companies operating in the other sectors of economy. They are primarily related to the financial result, revenue from sales and sales of insurance products, investments and financing techniques. One of the tasks of controlling is the pre-formulation of objectives. Therefore, each one of the set objectives, which can be represented by financial indicators, may be included in the information system servicing the controlling of the company. A number of information systems, focusing on objectives related to the financial position of a company, have been presented in specialized literature. Consequently, the most important objectives, as far as financial controlling of a company is concerned, are the objectives related to financial result, investments and profitability. Financial expression of the objectives is given by the indicators, which are mainly associated with the return on capital and return on owner's equity, or the indicators of profitability (*Shulte, C., 1996. pp. 411-415*). However, they appear to be a direct result of the way the investments have been managed, the operational activities of the insurance company and the final financial result that has been achieved. Some other authors also support the statement that the main objectives of a company are growth, development and profitability (*Dayle, A., 2001. p. 17*). In this case, growth and development should not be considered as identical objectives. Growth is associated with the increase in sales revenue compared to a prior period and the expansion of market share of nsurance products, which have already been offered. Development implies offering new insurance products, new methods of sale and distribution of insurance services, entering new markets, etc. The main objectives - growth, development and profit should be balanced. The increase in sales revenue and market share should not be at the expense of profits. There are numerous examples in the business activities of non-life insurance companies, where one company or another, with a high premium income, generates a negative financial result for the current year. The reasons for this can be different, but one of them is aiming at maintaining competitive prices, that are not adequate to the risk assumed by the insurer.

As it has already been noted above, specific financial indicators are used when formulating the objectives of a company. In terms of controlling, some of the most important indicators are the following (Dayle, A., 2001. p. 22):

- growth of sales revenue compared to the previous year;
- increase in market share;
- defining the target return on invested capital (ROI);
- defining the target return on the cash flow.

In the study presented below, it is assumed that the leading indicator, when assessing the performance of the company, is the return on invested capital (ROI). For the purpose of formulating this objective, the planned budget (Table 1) for the profits of Allianz Bulgaria IJSC for 2018 has been used.

Table 1
Planned budget for the profits of Allianz Bulgaria IJSC for 2018 ,
in thousands of BGN

I. Technical plan	in thousands of BGN
1. Premiums earned, net of reinsurance	140 000
2. Other technical income, net of reinsurance	4000
3. Incured claims, net of reinsurance	-80000
4. Changes in other technical reserves, net of reinsurance	-300
5. Bonuses, Discounts, net of reinsurance	-800
6. Net operating costs	-50000
7. Other technical expenses, net of reinsurance	-5000
Balance - Technical plan	**7 900**
II. Non-technical plan	
1. Balance – technical plan	7 900
2. Investment income	5000
3. Investment costs	-1000
4. Other expenses	-300
Profit	**11600**
Corporate tax	1160
Net profit	**10440**

Author's calculations

The question arises as to how to determine the planned value of an indicator in formulating the objectives of the insurance company. In practice, there are various variants when developing the planned values of indicators. One of them suggests making projections based on data from previous years. There are a number of models that enable the prediction of future development based on the existing information. This information can be derived from the accounting records or based on the insurance company's internal records. This approach enables the formation of a trend and development of forecasts, respectively. Another option when developing a forecast is to take into account the average values in the sector of insurance. This option may prove to be ineffective, provided that the sector is not developing well in general. An alternative to this option is having the opportunity for comparing the company to the sector bests. In this option, competitor's values are taken as a benchmark when setting the objectives of the insurance company. Regardless of which of the options will be adopted when setting the object-tives, what should be taken into account is the factors related both to the internal and environmental aspects of the insurance company.

The planned budget, indicated in Table 1, shows the distribution of income and expenditure of the company on key items.[5] The planned budget is based on a high financial result that, if achieved, will provide the company with sufficient funds for its future development. There are two sources of formation of a high financial result. First of all, this is the high income from insurance business. Secondly, this is an ambitious investment plan, which relies on significant revenues from investments. However, even if high premium income has been realized in the course of the year, may not be a guarantee to achieve the target profit of the company. This is due to the fact that, unlike real sector companies, insurance companies sell products that carry a certain amount of risk. Therefore, an insurer can never be sure what the manifestation of risk will be in the insurance group, respectively, what the amount of the insurance payments will be. This is where controlling is applied, including the phases of planning, control and analysis. Upon detecting significant deviations from the planned financial result, controlling should give information on the reasons for these deviations and give the manager suggestions for decision making. Provided that the profit target is not achieved due to unforeseen increase in the amount of insurance benefits that have been paid, the impulse for a solution should be sought in risk management. In this case, attention deserve all risk management techniques in the insurance company, including risk aversion (through exclusion of clauses in the insurance contract) and risk control in the insurance group.

The planned value of the indicator return on invested capital indicator is obtained by dividing the value of the planned operating profit by the amount of the capital, which is expected to be invested during the year (*Dayle, A., 2001. p. 24*). The amount of capital that the company is expected to invest over the year, is worth BGN 280 million.[6] The operating profit includes profit before payment of interest on loans and taxes. According to the data from the balance sheet for the past year, the company has not received any bank or debenture loans. This gives grounds to assume that during the planned year there will be no costs associated with paying interest on

[5] Budgeting, including defining the value of invested capital and planned value of the ROI is based on financial statements published by 'Allianz Bulgaria' IJSC on the FSC's website until September 2017.

[6] It includes planned value of all investments in 2018, including long-term and short-term assets.

borrowings. Under these conditions, the planned operating profit of the company is BGN 11.6 million. The value of the ROI indicator for the planned year will be 4.1%.

Setting a target value of 4.1% with respect to the indicator that is being analyzed means that the company managers expect every 100 units of invested capital to bring them approximately 4 units of operating profit. After payment of taxes by the company at the end of the financial year, the net profit is expected to be approximately BGN 10.5 million. If it is not distributed in the form of a dividend, this profit will be invested back into the company, thus ensuring its future growth.

The above-mentioned objective needs to be adapted in the context of the company's information system. The role of the information system is to facilitate corporate controlling. It should provide information on the planned indicators that are used to formulate the objectives of the insurance company, the actual deviations from the objectives and the reasons for these deviations. The information system of the company is a system of indicators. These indicators follow a certain logical connection. Different versions of information systems can be found in specialized literature. One of them is the Dupont system. This system is widely used in financial analysis (*Zahariev, A. et al., 2016, pp. 112-114*). Figure 3 shows a variant of the Dupont system (*the scheme is according to Shulte, C., 1996, p. 411*).

In principle, the information system has a pyramidal structure. On top of the pyramid there is one indicator, which is defined as a leading one or purpose. This indicator summarizes the business activity of the company and provides information on the degree of profitability or return on invested capital. The indicators, which are identified as factors within the information system, lie at the base of the pyramid. Thus, it becomes possible to uncover the causes and identify the factors that influence the final summary indicator.

The Dupont system sets the return on invested capital as a leading indicator. Generally, the information system analyses the profitability of sales revenue, measured by the operating profit margin and the return on owner's equity, representing the ratio between sales revenue and the value of investments. The business activity of an insurance company, however, is very specific.

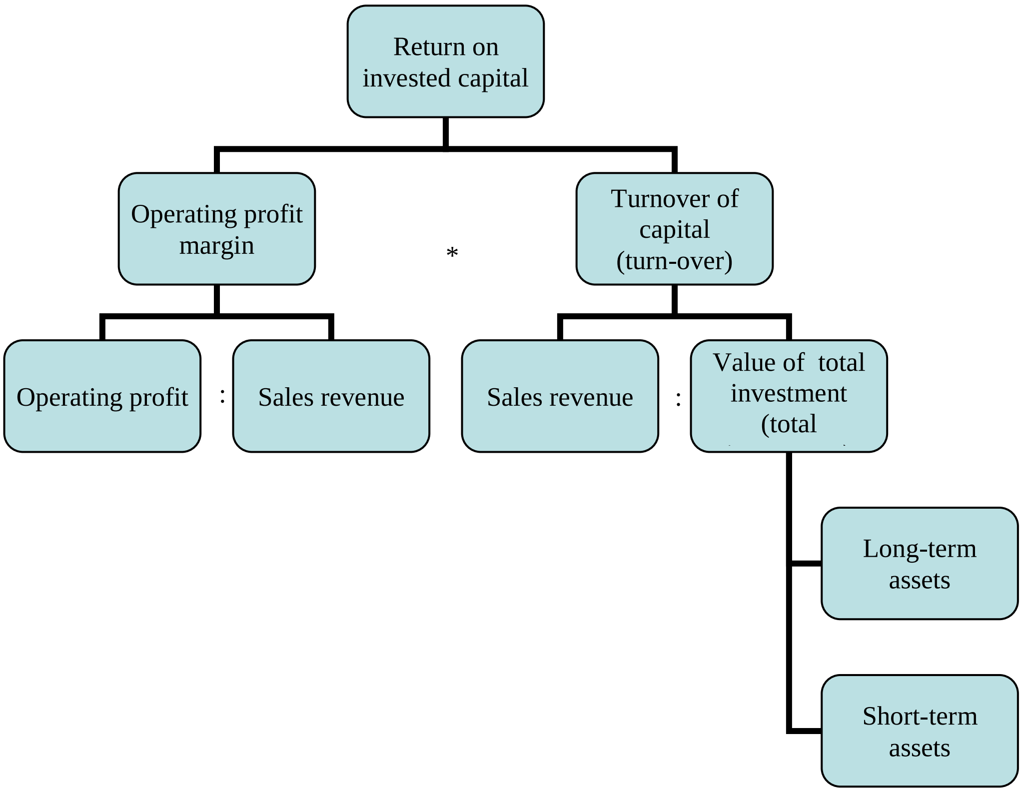
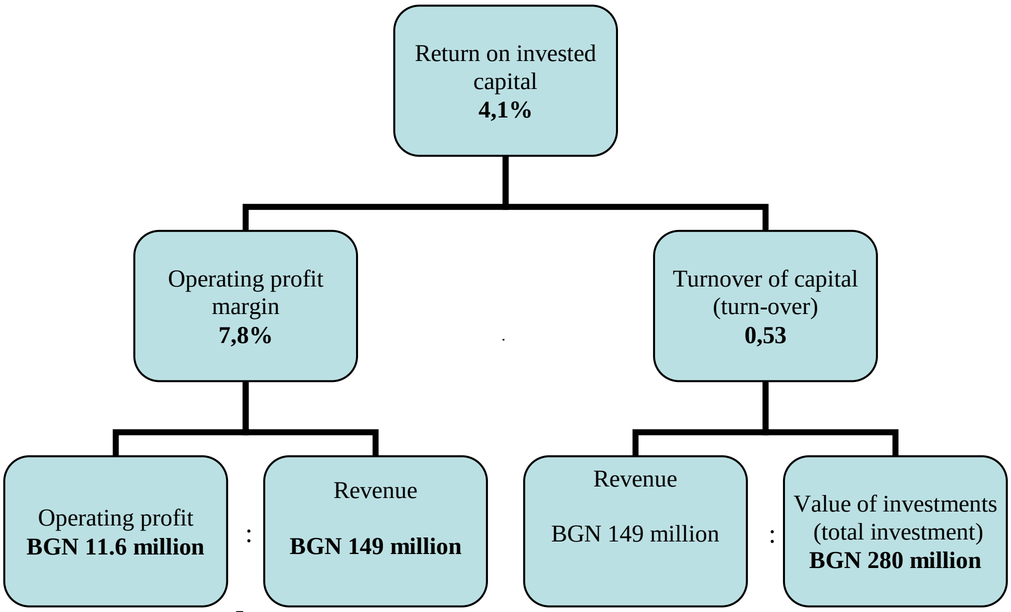


Figure 3. The Dupont system

The formation of financial results involves both revenue from sales of insurance products (in terms of premium income) and income from investments.. It would be therefore, globally, more appropriate to calculate the profitability of an insurance company not on the basis of the generated premium income, but on the basis of the profits of the insurance company as a whole. For purposes of analysis, the profitability of the sales revenue and the return on the investment portfolio can be calculated separately. Figure 4 shows a variation of the Dupont system, adapted for Allianz Bulgaria IC. The system has been developed on the basis of the Budget profit of the company for 2018.



Author's calculations[7]

Figure 4. The Dupont system, adapted for Allianz Bulgaria IC – planned values for 2018

The Dupont system shows two things. First, the company has a low capital turnover, due to the relatively high value of the invested capital. Second, the company has managed to compensate for the relatively low capital turnover with high margin of operating profit. The product of the values of the two factors gives the value of the return on invested capital. It is the numeric expression of the objective which has been pursued by the insurance company.

*   *   *

Financial controlling has the objectives at its core. The objectives of an insurance company relate to the profitability indicators, although they are not limited to that only. Increasing the market share and revenue from sales of insurance products can also be set as objectives of an insurance company. As mentioned above, a balance should be sought between the objectives set by an insurance company. Companies that are marketable (traded on the stock exchange) should have increasing the market value of owner's equity as their

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[7] What is meant by revenue is all proceeds of the insurance company, including the earned premium, net of reinsurance and investment income.

main objective. A problem that arises in the practice of the insurance companies in Bulgaria is that, currently, they do not consider the capital market as the market where they can accumulate additional capital. Insurance companies do not take into consideration the advantages that the capital market provides, namely - transparency, publicity, easier access to capital. Therefore, the objective of increasing the market value of owner's equity cannot be on the agenda in the context of financial controlling of an insurance company.

Apart from formulating the objectives, the role of financial controlling is detecting deviations from the objectives and analysing the reasons for these deviations. An insurance company should have an employee performing the role of a financial controller (about the controller's position in the functional structure of a company, see also Dayle, A., 2001. pp. 272-280). This person should be responsible for collecting information from all directorates and departments of an insurance company with the aim of creating an information system, which will be of service to financial controlling. Upon detecting significant deviations from the objectives set by the company, the role of the financial controller is to inform the managers of the insurance company. It should be noted that the financial controller has no managerial functions. Their role is not to decide but inform the managers of the insurance company about the problems. It is the managers who are in charge of adequate decision-making when informed by the financial controller about the problems.

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- font – Times New Roman14 pt;
- margins – Top - 2.54 cm; Bottom - 2.54 cm; Left - 3.17 cm; Right - 3.17 cm;
- page numbering– bottom right;
- footer text– size 10 pt;
- graphs and figures– Word 2003 or Power Point.

4. Layout:

- title of article, name of author, academic position and academic degree – font Times New Roman, 14 pt, with capital letters Bold – centered;
- workplace, postal address, telephone and E-mail;
- abstract in Bulgarian up to 15 lines; key words–3 to 5;
- JEL classification of publications on economic topics (http://ideas.repec.org/j/index.html);
- main body (main text);
- tables, graphs and figures are software inserted in the text (they should allow linguistic corrections and translation in English). Numbers and text in them should be written with font Times New Roman 12 pt;
- formulas are inserted with Equation Editor.

5. Rules for footnote: When citing sources, authors should observe the requirements of **APA Style** at http://www.apastyle.org/ or at http://owl.english.purdue.edu/owl/resource/560/01/ or at http://www.calstatela.edu/library/guides/3apa.pdf.

Each author is responsible for promoting ideas, content and technical layout of the text.

6. **Manuscripts of lecturers without an academic** rank should be accompanied by a transcript of the minutes of the Department meeting at which the proposed paper was discussed.

From 1st of January 2017 the English language title of the journal is changed from "Narodnostopanski archiv" (transliterated from Bulgarian) to "Economic Archive".

Authors of papers published in Narodnostopanski arhiv journal are responsible for the authenticity of the materials.

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