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# The connection between financial management and financial control

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**Abstract:** The feature of a quality system within an organizational system in the management and financial control means a coherent legislative framework and financial reporting, determined in relation to invested or spent budget funds. The business process such as reporting, planning and execution of the budget or of the financial plan in public procurement, was closely associated with accounting reporting and with the implementation of an act of fiscal responsibility.

**Key words:** management, budget, control, financial, prediction

**JEL Classification**: M41, M42

## 1. Introduction

Financial forecast is the process of predicting inflows and outflows of funds from entities on long term in the future. Outflow of funds must balance long-term inflow. The globalization of business is the financial forecasting function that has become more complex since work on several national markets must be strengthened, taking into account the vagaries of several national currencies. The analysed scenario is widely used in order to prepare the entity for various contingencies.

## 2. Financial control tools

The main instruments of financial control in an entity are budgets. A budget specifies the resources involved in a plan or for a specific project or for a period of time. Fixed budgets are independent of the activity of the unit for which the budget is drawn. Flexible budget committes resources to the level of activity. Spreadsheet programs are the main tools of budgeting. Spreadsheets are personal productivity tools currently used in preparation of the budget.

While management sets budget users, financial control is obliged to introduce a plan to eliminate weaknesses and imperfections, which can be attached to the statement of fiscal responsibilities, in accordance with the Rules of preparation and delivery of tax returns. Fiscal and budget responsible[1] are all users who report to the Ministry of Finance, responsible for the development of financial management and control in parts of planning, of budget, of execution / financial plan, of public procurement, of accounting and reporting.

Business processes adopt written procedures and controls, and regulations within the healthcare system, education and the social benefits system, and compensation, representing the connection between financial management and financial control in charge of taxation.

[1] Official Gazette 78/11, http://narodne-novine.nn.hr/clanci/sluzbeni/2011_07_78_1648.html

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Given the link between financial management and control and fiscal responsibility, it is necessary to define and regulate those processes that require written procedures on fiscal responsibility. The procedure of creating contractual obligations include the process of making a financial plan and a procurement plan[2].

The activities listed in organizational procedures should focus on the development of control activities, of systems of recording and reporting in order to ensure legal uses dedicated in order to cover all the gaps declared from the funds.

The strategy of control and management over the past decade, Balanced Score Card (BSC) (Kaplan, Norton, 1996), has become one of the effective tools for managing the implementation and monitoring the execution of the strategy as it helps aligning the strategy with the expected performance and underlines the importance of financial objectives for employee's functional areas and business units. BSC ensures that the strategy is translated into objectives, operational actions, financial objectives and focuses on four main dimensions: financial, learning and growth, customer satisfaction and internal business processes factors.

The financial system has been for a long time the standard for assessing the performance of a company. BSC supports the role of finance in establishing and monitoring the specific and measurable objectives based on strategic and financial coordinates, thus allowing the entity to operate efficiently and effectively. Financial objectives and values are based on „best in industry" benchmarking and include:

***Cash Flow***

Cash Flow is a measure of financial solvency of the company and shows how effective the used financial resources are to generate additional cash for future investments (Grant, 1997). This represents the available net cash after reducing investment and increases of the capital of cash flow exploited by the company. Companies should use this value when they anticipate substantial capital expenditure in the near future or for the implemented projects.

***Added value***

The added value is a risk-adjusted basis and it is aided by management through effective decisions in a timely manner to expand business that increases the economic value of the company and which implements corrective measures (Grant, 1997); is determined by deducting the cost of capital operated in net income. Companies set objectives with added value in order to assess the economic contributions in business evaluation and the improvement in the process of resource allocation.

***Managing assets***

Managing the assets requires effective management of current assets (cash, receivables, inventory) and current liabilities (debts, commitments), turnover, improving capital management and cash conversion. Companies should use this practice when their operating performance falls inside benchmarks in the industry or assessed companies.

[2] http://www.mfin.hr/en/financial-management-and-control

***The financing decisions and capital structure***

In this case funding is limited to the optimal capital structure (indebtedness degree or leverage effect), being the level that minimizes the cost of capital of the company. This optimal structure of the capital determines company's ability of loan reserve (on short and long term) and the potential risk of financial problems (Barton, Gordon, 1987). Companies establish this structure, when their cost of capital rises above the one of direct competitors and there is a lack of new investment.

***Profitability indicators***

These indicators are a measure of an entity's operational effectiveness. Profitability indicators also indicate inefficient areas requiring corrective actions of management, measure the relationship between profit and sales, total assets and net worth. Companies should objectively establish the rate of return when it is required in order to operate more efficiently and to improve activities compared to chained value.

***Growth indicators***

Growth indicators have assessed incresed sales and market share, have acceptable determined the growth deal regarding cuts in cash flow, profit margins, and returns to investment. Increasing ussualy drains in cash and in reserve of borrowing funds, and sometimes in aggressive asset management, being necessary to ensure enough cash to limited loan (Gale, Branch, 1981). Companies should objectively establish the growth indicators, when growth rates have lagged behind industry norms or when they have the operating effect of the higher leverage.

***Assessing and managing risks***

An entity must address its key uncertainties through the identification, measurement, control and existing risks in corporate governance, their likelihood, and their economic impact and also compliance with regulations. Then, a process should be implemented in order to mitigate the causes and effects of these risks (Pforsich, Kramer, Just, 2006). Companies must make these assessments when anticipating a greater uncertainty in their work or when there is a need to strengthen their culture towards risk through fiscal optimization. Many functional areas and business units need to manage the level of tax obligations undertaken in conducting business and understanding that the risk of mitigation is reduced, also they are expected aven to diminish charges (Lawrence, 1994).

Moreover, new initiatives, acquisitions and product development projects must be weighed against the fiscal implications and contribution after tax. In general, the performance should, whenever possible, be assessed as a tax base. Global companies must adopt this measure when operating in different environments of taxation, when they are able to take advantage of the mismatch in tax regulations.

In conclusion, the introduction of Balanced Scorecard has highlighted the financial performance as being one of the key success indicators of an entity that helps in linking strategic performance objectives and

providing timely information to facilitate strategic and operational control decisions. This led to the role of finance in the strategic planning process to be increasingly more relevant than ever.

Empirical studies have shown that the vast majority of corporate strategies implements and monitors specific financial objectives aimed at strengthening the capacity of the organization with skills difficult to imitate and non-substitutable. They create sustainable competitive advantages that maximizes the value of a company, the primary objective of all stakeholders.

## 3. Conclusion

In our opinion the systems - theoretical, budgets serve as a standard for managers who are able to compare actual results with the help of computer systems. Performance reports are used to monitor budgets on different managerial levels. A performance report showing the actual financial results achieved by the unit and compare them with planned results. With budgets and performance reports, financial control has a number of financial indicators that indicate the performance of the business unit. A financial report widely used is the return on investment (ROI). ROI shows how well a business unit uses resources. Its value is obtained by dividing the earnings of the business unit to its total assets.

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