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### COMPLIANCE AS FACTORING BUSINESS RISK MANAGEMENT: CONTROL ASPECTS

*Indetermination of modern economy conditions and the lack of theoretical knowledge gained by domestic scientists about risk in factoring business actualize the research concerning the methodology and technique of factoring companies' risk management. The article examines compliance which is the technology innovative for Ukrainian market of factoring risk management technologies. It is determined that the compliance is the risk management process directed to free will correspondence to state, international legislation as well as to the ethics standards accepted in the field of regulated legal relations and to the traditions of business circulation to sustain the necessary regulations and standards of market behaviour, and to consolidate the image of a factoring company. Compliance risks should be understood as the risks of missed profit or losses caused by the conflicts of interests and the discrepancy of employees' actions to internal and external standard documents. The attention is paid to the control over the compliance. The author singles out 3 kinds of the compliance control such as institutional, operational and the compliance control over the observance of conducting business professional ethics regulations which are necessary for providing of efficient management of factoring business risks. The paper shows the organizing process of factoring business compliance control (by the development of internal standard documents, a compliance program, the foundation of compliance control subdivision, monitoring of the risks) cause the choice, made by management entities of a factoring company, of the management methods of risks for their business. The development of new and improvement of existed forms of compliance control organizing process help satisfy users' information needs and requests of the risk management factoring company department. The suggestions proposed create the grounds for the transformation and improvement of factoring companies' risk management technology.*

**Keywords:** factoring; factoring company; compliance; compliance risks; compliance control; risk management.

**Settlement of the problem.** Factoring business is characterized by the high level of risks. In modern economic conditions risk is an integral part of functioning of any factoring company and requires quality management to minimize its negative effects. Nowadays, various risk management technologies and methodologies are offered but among all of them the system of risk management on the base of the compliance technology deserves of special attention.

**Analysis of the latest research and publications.** The problems of risk management of factoring operations were researched by such scientists as L.M. Zayema [3], L.M. Kozhyna [6], I.M. Travish [9], A.M. Shanina [12], N.Dimitris [13] and others. It's necessary to indicate that a lot of aspects concerning the factoring business risk management are debatable and require detailed learning.

Compliance is the research object for many scientists in different fields, but its role and place particularly in the factoring business risk management are not learned enough. Thus, at present, the research of compliance as the method of factoring business risk management as well as the determination of its influence upon the quality of corporate management are so urgent.

**The purpose of the research** is to improve the factoring business risk management methodology with the help of compliance.

**Statement of the research.** The factoring company's activity is always connected with some risk, that is, with the possibility to reach success or failure in the planned scenario that results in a profit or loss. As a rule, the result of risk is determined when discrepancies between desirable and real data are compared. It is known that the risk is the result of situation uncertainty, that is, there is inexact or incomplete information about the meaning of various scenarios connected with the future period of time, about the conditions of realization of concrete management decisions and the expenditures that arise during this process [4]. This uncertainty may be caused by chances, the shortage of information, psychological peculiarities of individuals who take these managerial decisions. It should be mentioned that the uncertainty in the development of events which are supposed to come in the future and inability of precise expectation and complete awareness of all the circumstances of the factoring company's activity transforms risk into the necessary element of any managerial decision.

We are going to examine compliance which is the technology innovative for Ukrainian market of factoring risk management technologies.

Compliance is considered as the observance of laws, regulations and standards of a factoring company and as a whole it includes such matters as the necessary accomplishment of market behavior standards, the management of conflict of interests, fair treatment with clients and fulfilment of their desires [14, p. 101].

The term Compliance when translated from English means the correspondence to any demands or standards, external and internal [7]. The concept of compliance was borrowed from The USA Law «About corruption activity abroad» and similar laws of other countries [5, p. 23]. Under the term they understand all the actions which the entities of law are bound to carry out according to the demands of the present legislation in a whole.

Voloshenko A.V. [1, p. 405] researches compliance as a preventive system of struggle methods against corruption.

Haritonov M. [10] examines the concept of compliance from three sides (fig. 1):

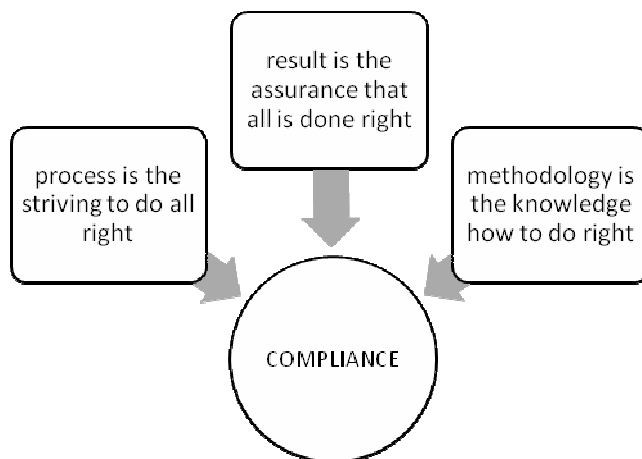


Fig. 1. Essence of the concept of compliance according to Haritonov M. [10]

Donilin O. considers compliance as the principle of conducting business by a factoring company in accordance to the applicable legislation, regulations, codes and standards, constituted competent authority, professional associations and internal documents of this organization [2].

Tsyutsyak A.L. states that compliance foresees the observance of laws, the ethics of conducting business and corporate compliance program [11] and examines compliance as the process of compliance risk management.

Ukrainian legislation has confirmed the concept of compliance risk for bank activities, namely by the decree of NBU № 98 of 28.03.2007. The decree understands the compliance risk as the risks of juridical sanctions, financial losses or loss of a reputation because of nonfulfillment by an establishment of the demands of the Ukrainian legislation, normative acts, internal principles and regulations, as well as standards of self-regulating organizations that are applied to its activity. Inability to foresee the influence of improper actions of organization officers may result in negative social resonance and do harm to the organization reputation even if demands of the Ukrainian legislation were not broken [8].

According to the research results of scientific sources we consider compliance to be the risk management process directed to free will correspondence to state, international legislation as well as to the ethics standards adopted in the field of regulated legal relations and to the traditions of business circulation to sustain the necessary regulations and standards of market behaviour, and to consolidate the image of a factoring company.

Compliance risks should be understood as the risks of missed profit or losses caused by the conflicts of interests and the discrepancy of employees' actions to internal and external standard documents.

Compliance risk includes the following:

- the risk of applying juridical sanctions;
- applying sanctions of regulating organizations;
- essential financial loss;
- reputation losses of a factoring company.

Thus, compliance is a set of particular technical functions, their realization allows to manage legal, reputation and some operational risks.

These risks are quite essential and can cause a great number of unpleasant effects, that's why it's easier to prevent them than struggle with the results and losses caused by them.

The process of factoring company compliance risk management foresees compliance control organizing. The compliance control consists in the development and implementation within a factoring company programs and strategies which, on the one hand, are directed to minimize the appearance of compliance risks, and, on the other hand, are the means of positioning of the company which conducts open commercial activity free from corruption schemes. The compliance control is accomplished continually and includes all the stages of business processes.

Some organizations restrict themselves by using the internal control regulations which often don't include to the full extent all the necessary aspects that influence upon their financial state and the level of their business

reputation. Practising such regulations is at least «a good manner», but it's not enough for performing a valuable control and monitoring the factoring company activity and also its relationships with state authorities, clients, debtors and so on. There are the companies where their management, catching all the significance and obligation of such a control, spends much money to develop the policy and procedures which in their turn, create the basis for making of self-sufficient and effective system of compliance risk management.

It is necessary to indicate that developed countries have various directions of compliance control, for example:

- investment which regulate the problems of «right» and «fair» sale of investment products;
- tax which regulate the problems of maximum observance of tax legislation;
- client which regulate the problems of fair treatment to clients (Treat Customer Fairly);
- credit which regulate the problems of fair crediting (Fair Lending Policy) and others [4].

As it is already known that the risk management system includes the following actions connected with:

- ✓ «detection» – the ability to identify risks;
- ✓ «prevention» – the control of risks;
- ✓ «reaction» – the ability to react and act in concrete situations correctly [4].

The purpose of any functions compliance control is maximal removal of possibilities of any risk appearing or minimization of its effect. Taking into account the essence of compliance, the compliance control expects:

- finding and assessment of compliance risks connected with the factoring company activity, and the regular assessment of a level of such risks;
- supplying the authority with the recommendation about the observance of the present laws, regulations and standards;
- development of written instructions to the company's personnel about employees' proper observance of the laws, regulations and standards including the laws concerning the struggle against money-laundering;
- assessment of the correspondence of internal procedures and operations to the functioning legislation;
- training of factoring company personnel about employees' observance of the laws, regulations and standards.

The important instrument of the compliance control is the internal regulations that put limitations on handing presents by a state employee, the rules of hospitality manifestation, the procedure of beneficial payment coordination and others. Special attention is paid to the reputation checking of business partners, distributors, contractors, intermediaries and agents who supply companies with different services. Such procedures have to discover hidden risks when corruption actions are disguised as quasilegal consulting services, marketing researches or excessively raised presales prices.

Very effective component of the compliance control is internal inspections and investigations to discover and prevent cases of company business ethics breaking. As a result of such inspections and investigations a business company controls itself independently assisting to stop corruption and other breaches of corporation regulations set up [1, p. 406].

The development of compliance control effective system in a factoring company is based on the identification of compliance risks, where their correct assessment determines further result of such program realization in an action. Principal place in this process takes the assessment of all the risks of internal and external environment, and these risks form key indicators to the map of compliance risks.

On the base of the research showed above we suggest the realization mechanism of compliance control system in a factoring company to minimize compliance risks (fig. 2).

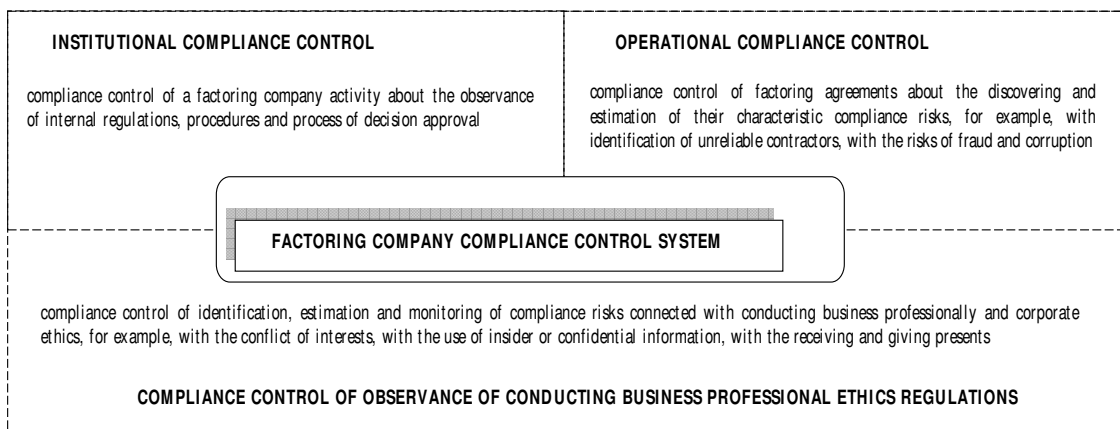


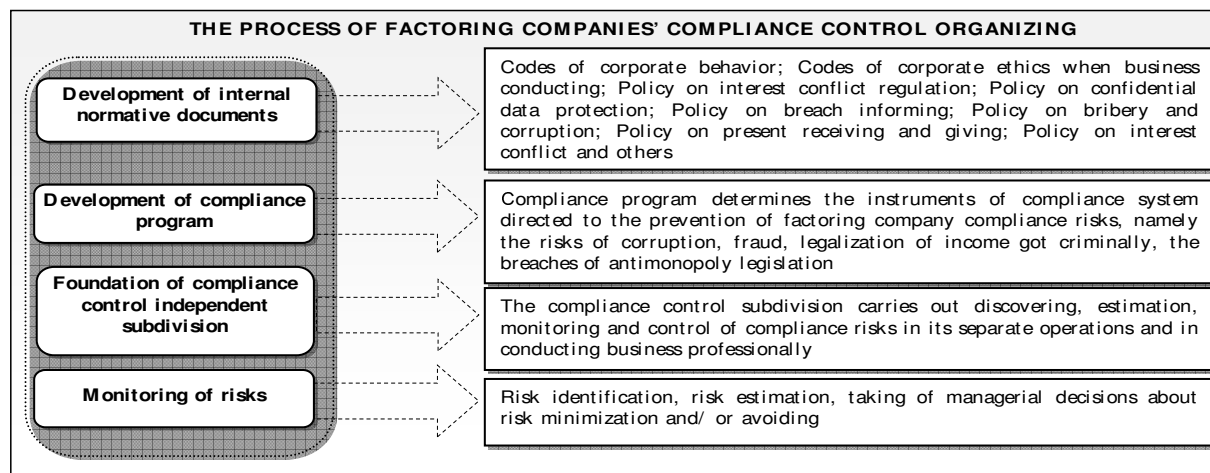
Fig. 2. Factoring company compliance control system

So, the establishment of the factoring company compliance control system has to include:

- institutional compliance control which is the control that expects the observance of set up internal regulations;
- operational compliance control is the control which is performed about the discovering and estimation of compliance risks and taking of managerial decisions on risk minimization and removal;
- compliance control about the observance of conducting business professional ethics regulations to carry out identification, assessment and monitoring of compliance risks connected with conducting business professionally and corporate ethics.

The application of compliance control in a factoring company will guarantee the possibility to monitor and identify the sources of corresponding risk manifestation.

The process of factoring company compliance control organizing is shown on figure 3.



*Fig. 3. The process of factoring companies' compliance control organizing*

The proposed factoring company compliance control organizing has to include four stages: development of internal normative documents; development of compliance program; foundation of compliance control independent subdivision; monitoring of risks.

The factoring company compliance risk management organizing includes the code of factoring company corporate ethics; the offers about personnel's hiring, the declaration about interest conflict, the obligations concerning agreement fulfilment failure, the personnel's estimation criteria, the training programs and qualification extension, especially on the items of risk assessment.

To guarantee risk management it's necessary for factoring companies to develop and confirm a package of internal documents (compliance program) for the compliance control:

- Codes of corporate behavior;
- Codes of corporate ethics when business conducting;
- Policy on interest conflict regulation;
- Policy on confidential data protection;
- Policy on breach informing;
- Policy on bribery and corruption;
- Policy on present receiving and giving;
- Policy on interest conflict;
- Policy on prevention and counteraction of legalization and laundering of income received criminally, and terrorism financing.

Compliance program will give the possibility to guarantee the control to minimize risks according to the standards of the present legislation in the field of law, finances, taxes, reputation, image and so on.

The main functions of factoring company compliance control subdivision are: the development of recommendations to management about the present regulations, standards, practices while compliance control organizing and implementation; the development and performing of reporting system on compliance risks and opening the information to the company's management about compliance risks in accordance to the established order; organizing of personnel training on the items of compliance control; introduction of conclusions and recommendations to the management about decreasing or removal of the discovered compliance risks; preparation of recommendations and comment on the policies that are being developed and used already, on standing orders, regulations, and procedures and monitoring of their observance to decrease of compliance risks which are adopted; the development of needs and recommendations about use of documents that establish the

standards for business conducting professionally; the development and implementation of the measures directed to the counteraction of legalization of money received criminally, terrorism financing, corruption and fraud; the development and implementation of the measures directed to the control of insider and confidential information use; the development and implementation of the measures to discover, assess and control conflicts of interests; receiving of complaints and messages about fraud and corruption of employees and third individuals, participation in prevention of breaches and conducting of their investigations; monitoring on the correspondence of the company's activity to the established compliance regulations; interaction and coordination of work about compliance risk management with factoring company's subdivisions.

Risk monitoring is directed to the assessment of the level of compliance risks. The procedure of risk identification and assessment within the compliance system has to discover the source and the result of the legislation breach or the breach of internal regulations that may cause financial losses or the loss of the factoring company's reputation.

**Conclusions and perspectives of further researches.** So, using the compliance technology a factoring company can organize a reliable compliance control decreasing its risks.

3 kinds of compliance control such as: institutional, operational and the compliance control over the observance of conducting business professional ethics regulations are necessary for providing the efficient management of factoring business risks.

Thus, the above researched process of organizing factoring business compliance control (by the development of internal standard documents, a compliance program, the foundation of compliance control subdivision, monitoring of the risks) cause the choice, made by management entities of a factoring company, of the management methods of risks for their business. The development of new and improvement of existed forms of compliance control organizing process help satisfy users' information needs and requests of the risk management factoring company department.

The suggestions proposed create the grounds for the transformation and improvement of factoring companies' risk management technology.

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Scientific interests:

– accounting and analytical supply of financial instruments.

Стаття надійшла до редакції 28.01.2016.