Discussion on internal control of account receivable of small and medium-sized enterprises

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Abstract. There are a large number of the SME in China, which occupy the majority of the enterprise. The SME are usually composed of individuals, a few people or families. The number of employee is small. Most of the production and operation of enterprises are directly managed by the owners and are less affected by the outside world. Therefore, there are many problems in internal control. At the same time, SME have a wide range of business scope, high operating costs, difficult economic benefits, poor ability to withstand operational risks, weak funds, and poor fundraising capabilities. On the one hand, account receivable can help enterprises expand sales and reduce inventory; on the other hand, the occurrence of bad debt in account receivable is not uncommon, and it greatly occupies corporate funds. Therefore, the study on the problems existing in the management of account receivable of SME is necessary. And the effective improvement strategy can help SME make full use of account receivable to improve the economic benefits of enterprises.

1. Introduction

Under the guidance of the trend of “mass entrepreneurship and innovation”, competition among enterprises has intensified. In order to gain an advantage in the market, enterprises adopt a credit sales model to expand sales. The reasonable and effective account receivable policy can optimize enterprise cash flow, improve the efficiency of the use of funds, help enterprises expand their market share and enhance their competitiveness. At the same time, unscientific Credit sales policy will not only lead to the payment cannot be recovered, but also cause bad debt, lose customers and greatly damage the corporate image. Therefore, effective management and reasonable control of account receivable can improve the efficiency of the use of funds, enhance the competitiveness of enterprises and enhance the soft power of enterprises.

2. Overview of internal control of account receivable

2.1 The definition of account receivable

Account receivable refers to the total price of the goods that the enterprise should collect from the purchaser or the unit that accept labor services during the normal business process, the taxes paid, and purchase the debtor side of the transport fees and other advances. Account receivable exists along with the generation of credit sales business and is one of the important means for enterprises to expand sales, increase market share and reduce inventory backlog.

2.2 The importance of account receivable

As a kind of commercial credit means, account receivable can reduce the inventory backlog of enterprises, reduce the inventory management cost and opportunity cost, increase the market share of enterprises and enhance the competitiveness of enterprises in the market; on the other hand, the existence of account receivable is the occupation of funds. It has a significant impact on the turnover of the company's capital. Strengthening the management of account receivable is a major problem facing the sustainable development of the enterprise. The effective management of the account receivable is to strengthen the internal control of the account receivable. Effective control can effectively accelerate the recovery of account receivable of SME, improve the efficiency of
turnover of production and operation funds of SME, reduce the bad debt losses of SME, and improve the economic benefits of enterprises.

2.3 Internal control theory

In 2008, based on COSO's internal control theory framework, combined with the actual development of China's enterprises, Ministry of Finance of the PRC, together with China Securities Regulatory Commission, the Audit Commission, China Banking Regulatory Commission, and China Insurance Regulatory Commission, formulated "The Basic Norms of Enterprise Internal control" which include five elements, such as internal environment, risk assessment, control activities, information and communication, internal supervision. It has been implemented within the scope of listed companies since July 1, 2009, encouraging non-listed large and medium-sized enterprises to implement. "The Basic Norms of Enterprise Internal control" that was formulated this time did not make mandatory requirements to SME. Ministry of Finance of the PRC has organized financial ombudsmen who come from various regions to survey the quality of accounting information of 159 SME in China. The result showed that the turnover of account receivable is slow, and capital recovery is difficult. SME are usually small in scale, inadequate in staffing, and organizational structure is incomplete. One person has multiple roles. It is easy to cause fraud. The perfect infrastructure construction of internal control is a favorable guarantee for improving the risk prevention and management level of SME. It is imperative to implement internal control management in SME. In 2017, Ministry of Finance of the PRC issued the “Standards for Internal Control of Small Enterprises (Trial)”, which raised the internal control of enterprises to a new important level.

3. The problem of the internal control of account receivable

Although the state has introduced relevant internal control regulations, the phenomenon that internal control regulations are greatly reduced in execution or not implemented without enforcement is still widespread. The problems in the internal control of account receivable mainly include the following aspects:

3.1 Lack of risk awareness and focus on sales

In order to quickly grab market share and expand sales, SME do not set up customer access mechanisms, do not set up departments that evaluate credit rating, lack in-depth investigation and research on customers, ignore the quality of customer, or set up departments that evaluate credit rating, the information that is collected about customer is only limited to business license, taxpayer identification number and so on. There is no multi-angle evaluation, such as the possibility of customer performance, solvency, financial status, etc. And there is no real-time update of customer credit information. The credit status changes are completely unknown, or the customer's credit rating is determined by the inherent thinking, which brings infinite hidden dangers to the recovery of account receivable, increases the business risk of SME, and hinders the sustainable and healthy development of SME.

3.2 The contract is signed that is not rigorous

The contract of SME is formulated by the finance department generally. But the financial department has less contact with customers. It is difficult to obtain effective customer credit information. The design of contract template is not targeted, and some loopholes exist. The contract signing process is completed directly by the sales department. Driven by the sales performance benefits, the sales staff changed some of the contract terms without authorization, facilitated the successful signing of the contract and carry out the sales business. It may result in the continuous generation of low-quality account receivable.

3.3 The responsibilities and the division of labor are unclear

The SME are small in scale, the organizational system is not perfect, and the business process is
defined unclearly. There are many conventions, and the implementation of policies is not strong. Many rules and regulations are ineffective. At the same time, the division of labor is not clear. The phenomenon that causes each to shift the responsibility upon another exists. There is a gap in process of the management of account receivable, which makes it miss a powerful time to recover account receivable.

3.4 There is a lack of effective communication between the various departments within the enterprise, and they are independent

All departments of the enterprise lack the overall awareness, only pay attention to their own business development, lack of effective communication between departments, the information cannot be shared in real time, and the information transfer is delayed. The sales department is only responsible for finding customers, signing contracts, issuing sales invoices, delivering invoices to complete sales operations. And the finance department is responsible for real-time accounting of recycling bills. Each department is only responsible for the superiors, and there is very little communication between them. The information cannot be delivered timely. That sets unnecessary obstacles to the recycling of account receivable.

3.5 The incentive and assessment mechanism is not sound

The idea of "sales first" for the SME is deeply rooted. The wages of SME employees are generally composed of basic wages and performance. The performance is mainly based on sales performance. There is no clear requirement for the quality about sales, resulting in that salesman still sign a contract with the client when they do not know the customer's credit, even knowing that the customer's credit risk exists. The reason is that they want to pursue sales and maximize profits. This phenomenon is widespread, leading to that bad debt rate of account receivable remains high. At the same time, the recycling system for subsequent account receivable is set less, and there is no punishment for the ineffective recycling of account receivable, and no corresponding incentive for the behavior of recovering account receivable faster. The enthusiasm of employees to recover account receivable is generally low. From the process of generating account receivable to recycling, there is a lack of necessary control and management, and there is a lack of account receivable assessment system. These further increase the amount of the bad debt of account receivable, which brings hidden risks to enterprises.

3.6 The internal supervisory department is absent

The SME is not large. The employee of many departments are set up to cross each other. The boundary between departments and departments are unclear. For example, the internal audit department is often set up in the finance department and is attached to the finance department. It is difficult to maintain the independence of auditing when judging whether the internal control operation of account receivable is valid, whether there is fraud, whether there are major errors etc. And it does not really play the role of internal supervision.

4. Measures to optimize the internal control of account receivable

4.1 Set up a special credit management department

Arrange special personnel to manage customer credit management within the enterprise, collect customer qualification information, conduct on-the-spot investigation of customer business status, visit customer cooperation enterprises to collect credit information, use internet media, the bank, the tax department to collect customer information, and comprehensively establish customer credit file, make a dynamic management for customer credit status, update relevant information in real time, and give a feedback to sales department and finance department timely, provide powerful reference for relevant departments to sign contracts and formulate credit policies, and make an effective beforehand control for account receivable, reduce the risk of bad debt losses of account receivable.
4.2 Avoid risks when signing contract and clarify responsibilities

When formulating a contract, the finance department should fully collect the opinions of various departments, grasp the market information timely, invite legal and technical professionals to carefully study the terms of the contract when necessary, clarify the responsibilities in the terms of the contract, and appropriately transfer the risks promptly. When a salesperson signs a contract with the customer, a third person must be present to ensure that the contract is rigorous. At the same time, the finance department strengthens the review of the signed contracts, ensures the correctness of the contracts, strengthens contract management, and ensures the quality of account receivable while ensuring sales.

4.3 Clarify the powers and responsibilities of the work and implement the responsibility to the people

Clear job responsibilities, draw down the boundaries of rights, decompose the responsibility, clarify the responsibility to the people, each department and each person perform their duties, designate a person to be responsible for the management of account receivable, and pay attention to the dynamics of account receivable in real time, improve work efficiency, effectively avoiding the breakage of the capital chain of the SME due to unsuccessful recovery of account receivable.

4.4 Smooth communication channels and establish an effective communication mechanism

Strengthen the communication between various departments of the enterprise, cultivate the overall awareness of enterprise personnel, and make the information transmission channels unblocked within the enterprise to realize real-time sharing of information. For example, the finance department timely transmits the ageing analysis of account receivable to the credit management department and sales department, which is beneficial to the credit management department to re-evaluate the customer credit rating, thus helping the sales department electively select customers who have better credit. The sales department timely transmits the sales information to the finance department, and the finance department promptly invoices and conducts necessary tracking management for account receivable. According to the specific conditions of account receivable, formulates appropriate collection policies and the plan that is about account receivable financing management. Mutual cooperation, mutual supervision and control between various departments can effectively improve the quality of account receivable, thereby enhancing the production and operation capabilities of enterprises.

4.5 Apply the performance appraisal mode of the balanced scorecard

Balanced scorecard performance appraisal is an assessment mode of all-round, top-down and different levels to all departments and employees. It is composed of the dimensions of customers, internal business processes, finance, learning and growth. The SME can refer to the balanced scorecard performance appraisal, and integrate indicators such as customer default rate, customer experience satisfaction, account receivable recovery rate, and sales staff training expenses into the internal control management of account receivable, and improve assessment mechanism that is about account receivable financing management. Make full use of financial index and non-financial index to strengthen the internal control of account receivable and continuously improve the quality of account receivable.

4.6 Introduce external supervision

The SME invite a strong independent accounting firm to review and evaluate whether if the internal control system of the enterprise's account receivable is perfect, whether if there are loopholes, whether if the enforcement of the system is appropriate. That can effectively avoid the information being unfair and not objective due to the lack of independent supervision of the internal supervision of the enterprise. That can improve the effectiveness and pertinence of internal supervision. At the same time, the existence of internal supervision can effectively help external supervision to fully understand the status of account receivable in a limited time. Integrating internal supervision with
external supervision, can improve the quality of supervision, improve the quality of account receivable, and ensure the healthy development of enterprises.

5. Summary
On the one hand, account receivable can effectively help enterprises to develop markets, increase sales revenue, reduce inventory backlog, and on the other hand occupy corporate funds, affect corporate capital turnover. How to make good use of account receivable of the SME is important in the fierce market competition. In view of the risk points existing in the internal control management of account receivable, the following precautions are proposed: setting up a special credit management department, attaching importance to contract signing, clarifying the rights and responsibilities of management of account receivable, smoothing information channels, and applying the performance appraisal mode of the balanced scorecard. Introducing external supervision on the basis of internal supervision to improve the internal control quality of account receivable. That can achieve real-time control of the whole process of account receivable in order to avoid the possible bad debts of account receivable. Thereby improving the enterprise's capital turnover rate, providing sufficient and appropriate production and operation liquidity for enterprise development, and enhancing the core competitiveness of enterprises.

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