

Research on Disclosure of the Internal Control Deficiency

Information of Listed Banks—based on the data analysis of 16 listed banks in 2014

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Abstract. The information disclosure of the internal control in the listed banks is an important mean to test its effectiveness, especially the disclosure of deficiency information. This paper treats the evaluation report of our 16 listed banks' internal control as a sample, using the method of descriptive statistical to analyze its actualities and then make some recommendations to promote the internal control of listed banks, improve their risk management capacity to ensure a sustained, healthy and stable development of our economy.

Background

The outbreak of the 2008 financial crisis is the trigger of people's upsurged concern of financial institutions risk management and internal control. As the core of the financial organization, the bank not only controls the country's financial lifeline, but also plays an important role in maintaining our country's financial security and stability. However, the bank industry has many features like obviously influenced by external factors, high-risk of conglomeration, high-debt ratio on the asset structure, low transparency information and asymmetric information all challenging its corporate governance. As the listed bank's first line of defence against financial risks, the internal control system bears many tasks like reasonably ensuring its legal compliance management, making sure the financial information and the related information be true and completed, maintaining the safety of bank assets, ensuring the achievement of strategy goals and business objectives. And the deficiency of its internal control makes these tasks be unaccomplished, it will bring a huge loss even the catastrophe to the bank. Thus, the listed bank should keep unsleeping attention on their internal control deficiencies.

Literature Review. According to "Sarbanes-Oxley Act" section 302 and section 404, the Public Company Accounting Oversight Board promulgated and revised the auditing standards and defined the concept and classification of internal control deficiency in financial reporting. Since then, foreign scholars studying the internal control deficiencies are mainly from their identification and deficiency information disclosure and other influential factors. In the identification of the disclosure of internal control deficiencies, Ge and Mcvay (2005) classified internal control into nine categories. They analyzed these 216 company disclosed significant deficiencies in internal control and found that the most recognized and disclosed internal control deficiencies are revenue recognized category, the final report and accounting policies, segregation

of duties and reconciliation of the accounts class category. In the influential factors of the disclosure of internal control deficiencies, Andrew.J.Leone (2007) found that the influential factors like the complexity of the organization, the organizational change and the investment in the internal control system etc. all affected its internal control.

At present, the domestic have studied the disclosure of internal control information a lot, some of which are related to the internal control and the disclosure of information deficiencies of listed banks. Wang Fei (2006) studied the manifestation of the internal control deficiencies in commercial banks, which analyzed its reasons and suggested to establish a maturity audit inspection system and improve the internal control system. Dong Huina and Zhu Zhixiong (2014) found that the internal control of listed banks existed many questions like the various scope of deficiency identification and the incomplete deficiency identification system, then proposed that supervision department should draw up reference standard system which is suitable for commercial banks' internal control guidance and internal control deficiencies identification and further strengthen the specific inspection of internal control. Qu Xu, Li Ming, Yang Dan and Ye Jianming (2009) chose the China Minsheng Bank as the study object, analyzed the actuality of disclosure material leak of listed bank's internal control. They suggested some measures like the improvement of material vulnerability information disclosure mechanism, identify relative main responsibilities increased the supervision and other measures to improve the quality of material disclosure of vulnerability information.

The disclosure circumstances of the listed banks internal control deficiencies

(i) Different evaluation contents of internal control. The construction of internal control system of listed banks is guided by Basic Standard for Enterprise Internal Control, Supporting Guidelines of Enterprise Internal Control, and Internal Control Guidance for Commercial Banks and others. Basic Standard for Enterprise Internal Control focuses on the content of each element of internal control; Supporting Guidelines of Enterprise Internal Control focuses on the internal control of fund activities, purchasing activities, sales activities, asset management and other business. While Internal Control Guidance for Commercial Banks focuses on the internal control of credit business, counter business, intermediate business and others. Under the influence of various internal control standards, there exists differences between the evaluation contents of the banks. Some banks focus on fund activities, asset management, financial report and other business to evaluate its internal control, some banks focusing on organization structure, the risk assessment of human resources policies, enterprise culture, internal audit and other aspects, and some banks focuses on internal control, risk assessment, control activities, information and communication internal supervision five aspects to evaluate its internal control.

(ii) Certain chosen space of the identification standard of internal control deficiencies. In 2010, China's Ministry of Finance and other five ministries issued Evaluation Guidelines of Enterprise Internal Control and Audit Guidelines of Enterprise Internal Control separated internal control deficiencies into grave defects, important defects and general defects based on their impact. The identify standards of the internal control deficiencies include financial reporting standards and non-financial reporting standards in quantitative and qualitative identification. The self-assessment report of China's listed banks' internal control based on the influence degree of enterprise internal control system on their deficiencies classified and specialized its identify standards, by analyzing the grave deficiency standards of internal control in 2014 listed banks' financial reports, it can be seen that, in the 16 listed banks, 14 banks disclosed their grave deficiency standards of internal control are specialized in financial report. From the quantitative

standards of grave deficiency of internal control in financial report we can learn that the different reference objects of material misstatement made the level of importance of corresponding items are also different, which made each bank's internal control deficiencies lack of comparability. From the qualitative standards, most banks defined some situations as material deficiencies: fraudulent practices of the directors, supervisors and senior managers; reconfirm the published financial report; certified public accountant found serious misstatement in financial report which internal control undiscovered in the operation.

(iii) Lack of information in the disclosure of internal control deficiency. This paper individually reviewed the internal control self-evaluation report of each listed bank and found that 9 banks did not disclose their internal control deficiencies and 7 banks did. Then, by a further analysis of the disclosure of internal control deficiencies, as shown on Table 1, we found that although the Bank of Communications, Shanghai Pudong Development Bank, China Merchants Bank, China Construction Bank and Industrial Bank disclosed their internal control deficiencies, the information is unclear, only recognizing the existence of some matters do not materially influence their management and even appears similar descriptions. The Bank of Beijing relatively specialized its internal control deficiencies and divided the general internal control deficiencies into individual business processes and regulatory operations two aspects. Ping An Bank disclosed the specific number of its internal control deficiencies have found, and detailedly described the reasons of the defects. Overall, the listed banks' disclosure information of internal control deficiencies is shortage and poor readable and difficult to truly provide decision-useful increment information for the stakeholders.

Table 1 Specific disclose circumstances of internal control deficiencies to listed banks

Bank Name	Disclose of internal control deficiencies
Bank of Communications	Matters to be improved, the company has identified, don't constitute a substantial effect on the soundness and reliability of the company's internal control system and the validity of financial reporting.
Shanghai Pudong Development Bank	Matters to be improved don't constitute a substantial impact on the management
China Merchants Bank	General internal control deficiencies exist.
China Construction Bank	Matters to be improved don't constitute a substantial impact on the Bank's management.
Industrial Bank	The risks that may be caused by general defects are found in the controllable range, which will not constitute a substantial impact on the company's assets security, the achievement of development strategic and operational objectives, the accuracy and completeness of financial information, the effectiveness of risk management system and result in deviation from the control target of company.
Bank of Beijing	Through the evaluation and testing of internal control, it reflects that the individual business process needs to be improved and the standardization of operation needs to be improved. By tracking the implementation, it has been largely rectified. As of December 31, 2014, the existed or not completed rectified deficiencies in internal control have been general defect. As it involves system development, system construction process and other reasons, the rectification has not been completed, and the risks these defects may result in are low or lower and are manageable, and also from the perspective of the summary, they do not pose a significant defects or material weakness, which does not constitute a substantial impact on the achievement of the Bank's financial reporting objectives.

Ping An Bank	The CSA-CSOX internal control self-assessment in this year has found 17 internal control deficiencies, and the audit internal independent evaluation has found 10 internal control deficiencies, which are low or lower risks. Among them, the design defects show system imperfections or function to be optimized, which accounts for 11% of internal defects; the running defects show system incoprehension or insufficient control measures resulting in compliance implementation not in place, which accounts for 89% of internal control deficiencies.
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(iv) The rectification of the internal control deficiencies trend to be a formality. Statistical analysis of the self-evaluation report of the 16 listed banks, we found that the rectification of the internal control deficiencies is simply a description. In 2014 the 7 listed banks disclosed their internal control deficiencies, only Ping An Bank relatively more specific disclosed its detects, other banks are incidentally even dose not mention its rectification. For example, Shanghai Pudong Development Bank said in the internal control self-assessment report, “will take further control measures to continuous improvement”; Bank of Communications said, “taken positive measures to improve and control, and will further improve the construction of internal control system, strengthen the excutive power of internal control, increase the supervision and inspection of internal control”; Industrial Bank is, “have already constituted specific scheme and measures and seriously implement the rectification”; Merchants Bank is, “the compony has instituted the rectification plan timely and implemented the measures actively”; Bank of Beijingsis, “the bank has developed rectification plan, taking measures like improve the system construction process and the system control, strengthen the supervision and inspection and internal assessment to accelerate the rectification of such defects”. Visible, the rectification of the internal control deficienscies basically been a formality and lack of specific content.

The suggestions to improve the disclosure information of internal control deficiencies to listed banks

(i) Set the disclosure content of internal control in detail. At present, the requirement of our nation to the listed companies are relatively simlpe, it does not specify the disclosure content, scope and evaluation basis, etc. making some compony trying to avoid the important and dwell on the trivial. In the self-assessment report of internal control, firstly, it should disclosure the statement of the administrations, the rule framework to effectively evaluate the internal control, the evaluation conclusions, the descripton of the significant risks and material weaknesses of the compony’s internal control etc. Secondly, it should detailed the provision the review range of the internal control deficiencies from the aspects like the objects of internal control, the five elements of internal control etc. Finally, it should clearly define the internal control deficiencies which need disclose its specific deficiencies and the rectification plans.

(ii) To establish a unified identification standard system of internal control deficiencies. In order to improve the identify standards system of the internal control deficiencieis of the listed banks, relevant departments should formulated releted laws and unified internal control systems that combined both quantitative and qualitative aspects. The quantitative standards can be determined by selected certai percentage of the defects’ cost in the size of the bank assets, operation revenue and gross profit, etc. but it should be clear that the important level of the significant internal control deficiencies, the important internal control deficiencies and general level of defects achieves making the comparable of the internal control deficiencies inter-banks. The qualitative standards can identify the defects of internal control from several aspects like the effectiveness of internal control, legal compliance, information disclosure, the repucation effect, data and information system, etc. and division the level of internal control deficiencies.

(iii) Improve the regulatory system and punishment mechanism of internal control. The level of the protection of investors' rights in a nation will directly affect its corporate financial markets and the developing level of the corporate governance. In order to protect investors' rights, eliminate the fluke mindsof the listed banks, the Ministry if Finance, Audit Commission, China Banking, Regulatory Commission, China Insurance Regulatory Commission, etc. have jointly issued the first corporate internal control rules in our nation, establishing an effective regulatory basic framework but still need embodied in actual operation. In terms of internal control, it need to improve the governance structure of the compony, identify the oversight responsibility of supervisors, independent directors and other departments on the aspect of internal control and information disclosure. In terms of external supervision, the China Banking Regulatory Commission, China Insurance Regulatory Commission and other external regulatory departments should regularly or irregularly conduct a special inspection of the internal control in listed banks. In addition, it is needed to identify the legal responsibilities of internal control and disclosure of the board of directors, the supervisors, the independent directors and the CPA, forming a sound accountability and punishment mechanisms to ensure the authenticity of the disclosure information of the bank's internal control and the fully implementation of the rectification plan of the internal control deficiencies.

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