

Internal Controls Defections of Small and Medium-sized Enterprises

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Abstract—In recent years, the role of Small and Medium-sized Enterprises (SMEs) in China to promote the development of the national economy is increasingly important. But their internal control is not in place, their long-term development is blocked. So this paper started from the internal control theory, SMEs in Nanjing of Jiangsu Province as a sample, using questionnaires as a survey method to collect data, then analyze and obtain the results of the current situation of internal controls and SMEs' problems. On this basis, this paper proposes some solutions of the existing problems of internal control for SMEs from five internal control elements.

Keywords—SMEs; internal control; internal control elements

I. INTRODUCTION

Since China's reform and opening up, especially in recent years, the SMEs of China have developed rapidly, and the number is increasing year by year, the level of development continues to increase. "SME Yearbook," the statistics show that in 2011 the regional industrial enterprises above designated size, the number of small and medium enterprises is 316498, accounting for 97.2% of the total industrial enterprises; small and medium enterprises total output value reached 492761.5 billion yuan, compared to 2006 of the data, an increase of 141.25% in five years. In addition, SMEs provide about 64.74% of the jobs, employing 59.357 million people. It can be said that SMEs are an important force in promoting social progress and economic development in China, playing an important role in promoting the growth of output and employment. Although the development of SMEs in China has made remarkable achievements, but overall there is a weak, small scale, low level of development and low risk of anti-problem, which undoubtedly hindered the pace of progress of SMEs. In view of this, this paper intends to combine theoretical and practical methods to explore the existing problems of China's internal control of small and medium-sized enterprises and solutions.

II. LITERATURE REVIEW

A. The Theory of Internal Control

Wu Shuipeng, Chen Hanwen and Shao Xiandi (2000) put forward that the COSO report on the construction of the internal framework of China's internal control framework for the inspiration and reference reflected in five areas, namely,

improve the corporate control environment, conduct a comprehensive risk assessment, establish good control activities, strengthen information flow and communication and strengthen the internal supervision of enterprises. Xie Zhihua (2009) think that the characteristics of organizational relationships within the enterprise is the supervisory relationship from the vertical performance and the checks and balances from the horizontal performance. The structure of control is determined by the nature of control. The relationship between checks and balances determines the structure of the control structure which is equal to each other. The supervision relation is expressed as the one-way control structure of the upper layer to the lower layer. Li Xinhe (2013) believes that internal control research exists formal, omnipotent and hollow defects, needed to redefine the internal control of the border, the establishment of risk prevention and control as the goal, to operational management as the main internal control system as the core internal control connotation.

B. The Problems and Countermeasures of Internal Control

Zhao Wenxiu and Hu Shujuan (2008) argue that the concept of internal control of small and medium-sized enterprises in China is weak, the management model is rigid, lack of risk assessment system, proposed to update the management concept of the enterprise, establish a scientific organization, establish the risk assessment mechanism. Zhu Rongen (2001) proposed that the development of internal control is inseparable from the promotion of the government. It should pay attention to the practical guidance of internal control and use the business cycle method to design the internal control of the enterprise, at the same time, pay attention to the coordination of the internal control management and the existing system and regulations. Zhang Chao and Wang Xiangnan (2012) argue that the enterprise accounting is the subject of internal control, accounting personnel and the understanding of internal control is essential. In view of the current situation of the low quality of the financial accounting personnel of the small and medium-sized enterprises in our country, we should strengthen the management system of the annual accounting qualification certificate system, effectively promote accounting knowledge of the small and medium-sized enterprises accounting and related laws and regulations, and improve the overall business Level.

III. THE DEVELOPMENT OF INTERNAL CONTROL

A. The Stage of Internal Containment

The stage of internal containment was widely considered to be before the 1940s. Internal containment theory is based on two basic assumptions: one is that the possibility of two or more people or departments unconsciously commit the same error is small; the other is that the probability of consciously fraud by two or more people or departments is much lower than one. The main approach is the internal division of responsibilities, not by a person or a department management, but the accounting bookkeeping, in-kind personnel custody, personnel rotation and other means to achieve control.

B. The Stage of Internal Control System

From the 1940s to the early 1970s, European and American countries successively completed the industrial revolution, the scale of production increased and the competition intensified, which brought about the emergence of internal control system. An audit committee of the American Institute of Certified Public Accountants (AICPA) issued an audit procedural bulletin No. 29 in 1958 to classify internal controls into two categories: internal management control and internal accounting control. The internal accounting control is related to the security of the assets and the reliability of the accounting records. The main contents include: authorization and approval; separation of functions such as bookkeeping, custody of assets and preparation of financial statements; control of property and internal audit.

C. The Stage of Internal Control Structure

In 1988, the United States AICPA issued the No. 55 "Audit Standards Manual", before the "internal control system" was replaced by "internal control structure". The manual considers that the internal control structure consists of three aspects, which are the control environment, the control program and the accounting system. Among them, the accounting system is a key factor, but also the direct use of the factors of the auditor. The concept of internal control structure out of the circle of "dichotomy of the system", emphasizing the importance of internal and external environment to meet the needs of business management.

D. The Stage of Internal Control Framework

The COSO Committee published the "Internal Control-Integration Framework" in 1992, which was supplemented in 1994. The internal control integration framework is composed of five independent and related elements: internal environment, risk assessment, Control activities, information and communication, and internal supervision.

1) *Internal environment*: Internal environment is the foundation of internal control of an enterprise, generally including corporate culture, organizational structure, human resources policy, anti-fraud mechanism and governance structure.

2) *Risk assessment*: Risk assessment is an important part in the process of internal control. Enterprises can identify,

analyze and scientifically evaluate the risks that may be encountered in the course of achieving the business objectives, and then determine the strategy of reasonable and effective risk avoidance. Generally includes four aspects: target setting, risk identification, risk analysis, risk response.

3) *Control activities*: Control activities are based on the results of a risk assessment. Refers to the enterprise in order to control the risk to bear within the scope of the measures taken, which is the specific implementation of internal control, including authorization and approval control, division of responsibilities control, budget control, performance appraisal control.

4) *Information and communication*: Information and communication refers to the enterprise timely and accurate collection of information related to internal control, and this information in an appropriate way to transfer between the various levels within the enterprise, in order to communicate effectively between departments and employees.

5) *Internal supervision*: Internal supervision is the supervision and inspection of the establishment and implementation of internal control, assessing the effectiveness of internal control and found internal control deficiencies which should be improved in a timely manner, including daily supervision and special supervision.

E. The Stage of Risk Management

In September 2004, COSO released the Enterprise Risk Management-Consolidation Framework, turning from the emphasis on internal control itself to the importance of risk management. The report identifies risk management objectives as four: strategic objectives, operational objectives, financial reporting objectives, and legitimacy objectives. The innovation lies in the integration of risk management theory and methods, the introduction of the concept of risk portfolio, risk preference, risk tolerance, enrich the connotation and extension of internal control.

IV. SAMPLE OF INVESTIGATION

The number of small and medium-sized enterprises in our country is large and the internal control situation is complex and diverse. In order to comprehensively understand the current situation of internal control of small and medium-sized enterprises in China, and then analyze the existing problems accurately so as to put forward countermeasures in a more targeted manner, this paper adopts the method of questionnaires to collect the information provided by enterprises.

Due to the wide distribution of SMEs in China, the objective conditions of this paper makes it impossible for all small and medium enterprises to conduct a questionnaire survey. So I selected 50 small and medium enterprises in Nanjing as a sample survey. In order to ensure the professional and accuracy of the investigation, the managers, financial officers and some employees of the enterprises are chosen as surveyees, and the questionnaire is filled in by secret ballot.

From October to December in 2014, distributed 250 self-made questionnaires in Nanjing, Jiangsu Province, and collected 238 copies. 231 valid questionnaires were obtained after verification and statistics. The effective ratio was 92.4%.

V. RESULTS

A. Internal Environmental

Awareness of internal control, most of the attention of SMEs is not enough, lack of knowledge. Only 6% of SMEs in the sample pay attention to internal control, while 26% do not have the awareness of internal control. Although most of the sample companies have set up internal control system with 64%, the implementation is not optimistic, 36% Of the internal control to become furnishings. In the corporate culture and organizational structure, only 14% of the corporate culture was valued, 68% of the enterprises did not attach importance to it. 46% of the sample companies believed that the organizational structure was reasonable, but 20% considered it unreasonable. On the other hand, only 12% of the sample companies considered that the recruitment process was fair. Only 8% of the sample companies often organized financial personnel to train relevant knowledge.

In summary, there is not enough attention on the internal control of SMEs, internal control is decoration, corporate culture is lack, organizational structure is irrational and human resources policy is not scientific.

B. Risk Assessment

The risk of the enterprise is everywhere and uncertain, so the risk assessment system is very important. The survey shows that most SMEs are weak in risk control. Only 6% of the sample companies have a strong sense of risk prevention, 58% of the corporate consciousness is weak; In addition, up to 70% of the sample companies did not assess the risk system.

In summary, there are poor awareness of risk prevention, the lack of risk assessment system and risk control on the internal control of SMEs.

C. Control Activities

Control activities to ensure that the instructions issued by the enterprise management can be achieved, so the design of control activities must follow certain principles. Of the 50 companies surveyed, 19 were based on corporate objectives for their internal control activities, but 31 were based on management preferences, and only 8 had a range of measures to protect internal control activities carried out smoothly, 26 companies have a small amount of security measures, 16 companies are almost no security measures.

In summary, the existence of control activities in the internal control of small and medium-sized enterprises in the design principle is not reasonable enough and not sufficient in the implementation of security issues.

D. Information and Communication

As the SMEs' management structure is simple, staff streamlined, the link between the upper and lower levels are more optimistic. Only 6 of the 50 sample enterprises have low communication frequency with the staff, but it should be pointed out that the survey shows that the communication between upper and lower levels is superior to that between the departments, and the internal control is often the "one-man show" of the financial department. Moreover, most of the sample companies did not use information systems, the proportion of companies with better use of only 20%, the initial use of the ratio of 64%, 16% did not use.

In summary, there is not ideal to contact the sector, internal control only rely on the financial sector and information technology is not high in the internal control of small and medium enterprises

E. Internal Supervision

In fact, supervision is a function of enterprise management. To ensure that the internal control implement in place and achieve well, then its supervision is essential. However, the survey shows that SMEs are not optimistic about the situation, there is no set of internal audit agencies accounted for 78% of the sample companies, and most companies do not regularly make internal control evaluation or supervision.

In summary, there is problem of lack internal control of internal audit departments, internal control of the supervision and evaluation.

VI. SOLUTION

The results of the survey reflect the existence of SMEs in our internal control more problems, I believe that the following measures can be resolved by the following aspects.

A. Establish Norms for Internal Control

Although China has issued in 2008, "the basic norms of internal control", but its mainly for large enterprises. There is a lack of internal control norms that apply specifically to small and medium-sized enterprises. SMEs are an important force to support China's economic development, compared with large enterprises there are many "congenitally deficient", such as: smaller, less competitive in the market. With the guidelines and constraints, SMEs can be faster and better to grow, continue to contribute to the socialist modernization.

B. Improve the Internal Control Environment

Most small and medium enterprises establish their own businesses, they have the spirit of adventure, dare to try. But often lack the understanding of internal control, not to be taken seriously. In view of the characteristics of small and medium-sized enterprises, managers have a direct impact on the staff and the entire internal environment, therefore, enhance the awareness of internal control plays a key effect to improve the control environment.

Small and medium-sized enterprises should establish a reasonable organizational structure within the limits of size

and capacity. Design organizational structure should pay attention to whether the division of labor is reasonable, clear division of powers and responsibilities, as far as possible to achieve the balance of power and staff power, to avoid the weakening of departmental functions brought about by a high degree of centralization.

Enterprises in the recruitment process should abandon the idea of cronyism, because recruitment is an important way for enterprises to inject new blood. At the same time, should also establish a staff training mechanism to continuously improve their operational capacity to ensure that enterprises with the times.

C. Enhance the Ability to Assess Risks

In fact, many small and medium enterprises have little ability to control external risks. For example, the appreciation of the RMB against the US dollar in 2008, many SMEs have not taken measures to avoid risks, resulting in export-oriented enterprises due to changes in exchange rates and huge losses.

SMEs want to continue to operate, there must be a sense of risk prevention, which requires companies to establish a risk identification system. They can regularly organize the analysis of external risks enterprise managers may face.

The risk assessment is to analyze and measure the possible impact of the risk on the basis of the identified risks. Small and medium-sized enterprises receive size and resources constraints, may not be able to set up specialized risk assessment departments. Risk assessment can be from the risk of the possibility of occurrence and the impact on business objectives of the two aspects of the analysis, the use of quantitative or qualitative analysis methods, the assessment can be used after the scale, risk maps and other forms for the higher managers to take The corresponding measures to avoid risks.

D. Optimize the Control Activities

Control activities are important to achieve business objectives and it runs through the entire enterprise at all levels and various functional departments. Design control activities must be based on the objectives of the enterprise as a starting point and the foothold, this principle is particularly important for small and medium enterprises. Based on the results of the risk assessment, the enterprise shall take all necessary measures to comprehensively manage and control the business activities. Control measures generally include: incompatible duties segregation control, authorized approval control, accounting system control, property protection control, budget control, operation analysis control and performance appraisal control.

E. Strengthen the Use of Communication

SMEs relatively large enterprises, institutions are more streamlined, so the establishment of communication channels is relatively easy. According to their own characteristics, SMEs can hold formal meetings or informal forums for members to provide a platform for information exchange. At the same time, given the two-way communication, feedback

mechanisms should be established to ensure the effectiveness of communication.

F. Strengthen the Internal Supervision

Enterprise internal audit is an objective and independent monitoring activities, can help companies reduce fraud, improve operational efficiency. In contrast to external auditing, internal audits are flexible, relatively independent and wide-ranging. As an important part of internal control internal audit, in many small and medium-sized enterprises this has not fully play the value or not be established, which is one of the reasons for the worrying situation of small and medium-sized internal control. Considering the characteristics of small and medium-sized enterprises, it may not be able to set up special internal audit institutions, which can follow the practice of establishing risk assessment system in this paper, and determine the internal auditors, give them certain rights and responsibilities. The role of internal auditing.

VII. CONCLUSION

Through the study of the internal control of China's small and medium-sized enterprises, I found that there is a big problem in its internal control from the internal control of the five aspects and propose solutions to the existing problems of SMEs internal control: establish norms for internal control; improve the internal control environment; enhance the ability to assess risks; optimize the control activities; strengthen the use of communication; strengthen the internal supervision. This provides policy guidance for SMEs to improve their internal controls.

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