

# The Research on the Practice of the Corporate Health Index

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## ABSTRACT

Risk control has always been one of the core objectives of corporate internal control. In the design and implementation of internal control in state-owned corporates, there are still unclear goals, and risk control awareness and goals are not always implemented. In order to change this situation, based on the analysis of the internal and external environment and related theories, this paper innovatively builds the corporate health index model and helps corporates to quantitative the internal control overall evaluation, does integration of existing financial evaluation system, builds financial professional coordination mechanism, highlights the value of risk protection coefficient, which guarantees the healthy development of the corporate in the future through the internal control overall evaluation and financial evaluation to make comprehensive evaluation of the company.

**Keywords:** *Corporate health index, Internal control evaluation, Financial evaluation, Healthy development*

## 1. INTRODUCTION

In the current increasingly fierce competition in the market environment, strengthening the internal control of corporates, eliminating adverse risks and improving the level of financial management has great significance for the long-term development of corporates. In risk control management, corporates need according to the requirements of the ministry of finance, state-owned assets supervision and administration, strengthen the risk control mechanism, perfect the risk control standard system, build a multidimensional supervision system, strengthen financial performance management, in order to provide reliable basis for corporate management and decision-making, which means that the corporate internal control also needs to transform innovatively from the afterward traditional static supervision to dynamic continuous supervision and regular evaluation. In order to build a world-class corporate with excellent competitiveness, improve the internal ability to prevent and resist risks and maintain safe and stable operation, and promote the high-quality development and management transformation and upgrading of the company, we need to establish a complete set of risk and financial evaluation system. However, the existing research has not improved the company's control system from the new changes of internal and external environment. In order to fill this research gap, this paper starts from external government regulation policies and internal corporate risks, and combines COSO risk performance curve to

expand the relationship between risks and performance, so as to build corporate health index and better guide corporate internal management.

## 2. THEORY

Internal control is a process in which a corporate formulates and implements relevant policies in accordance with relevant laws and regulations in terms of maintaining the safety and integrity of assets, ensuring the authenticity and accuracy of accounting information, and the economy and efficiency of operation and management activities. Internal control is the inevitable outcome of management modernization, is an important way to improve the efficiency of corporate management. It is a process, a way, not a purpose. Internal control system is not only a policy, a system manual or a form, which is closely related to everyone in the organization and affected by human.

### 2.1. Development of The Internal Control Theory

The emergence and development of internal control theory can be divided into the following five stages:

(1) Internal containment stage (before 1940s) After the 18th century, with the development of productivity, the corporate scale gradually expanded, and the internal audit system emerged. In the early

20th century, corporates began to establish an internal containment system. In order to prevent fraud, it was stipulated that no one person or department could participate in the whole process of handling economic matters.

(2) Internal control system stage (from 1940s to 1970s). The concept of internal control system is based on the idea of internal containment system. The relatively formed internal control system is composed of organizational structure, job responsibilities, relevant processes, relevant standards and internal audit. In 1958, the system dichotomy of Internal Control came into being. CPA, No.29, Scope of the Independent Auditor's Review of Internal Control, published by the American Institute of Certified Public Accountants, divided the elements of Internal Control into two parts, consisting of Internal Accounting Control and Internal Management Control. In 1972, the American Institute of Certified Public Accountants redefined the system dichotomy.

(3) Internal control structure stage (1980s to early 1990s). The Statement on Auditing Standards No.55 issued by the American Institute of Certified Public Accountants in April 1988 marks the development of internal control from internal control system to internal control structure. The elements of internal control also evolve from the two elements of accounting control and management control in the "system dichotomy" to the three elements of control environment, accounting system and control procedure.

(4) Internal control framework stage (1992-2003). In 1992 the United States against false financial reports committee subordinate professional organization issued the "internal control - integrated framework" report, the report identified the internal control framework, this paper expounds the internal control framework consists of control environment, risk evaluation, control activities, information and communication, supervision, the five elements and the five elements in detail are described and analyzed, and the content of the framework provides guidance for the company's internal control construction and content reference.

(5) Risk management stage (2004-present). Combined with internal control-Integration framework and SA law, COSO of the United States promulgated the Corporate Risk Manage-Integration Framework, or ERM for short. This is the first time that internal control has been combined with risk management. ERM is mainly to re-perfect the risk evaluation elements in the integrated framework and expand the risk evaluation elements into four elements of goal setting, event identification, risk evaluation and risk response, thus ERM risk management evolves from the previous five elements of the integrated framework to the eight elements of ERM risk management. The difference between risk management and internal control integration framework is that risk management is more inclined to

risk analysis and response, while COSO integration framework is more inclined to control activities.

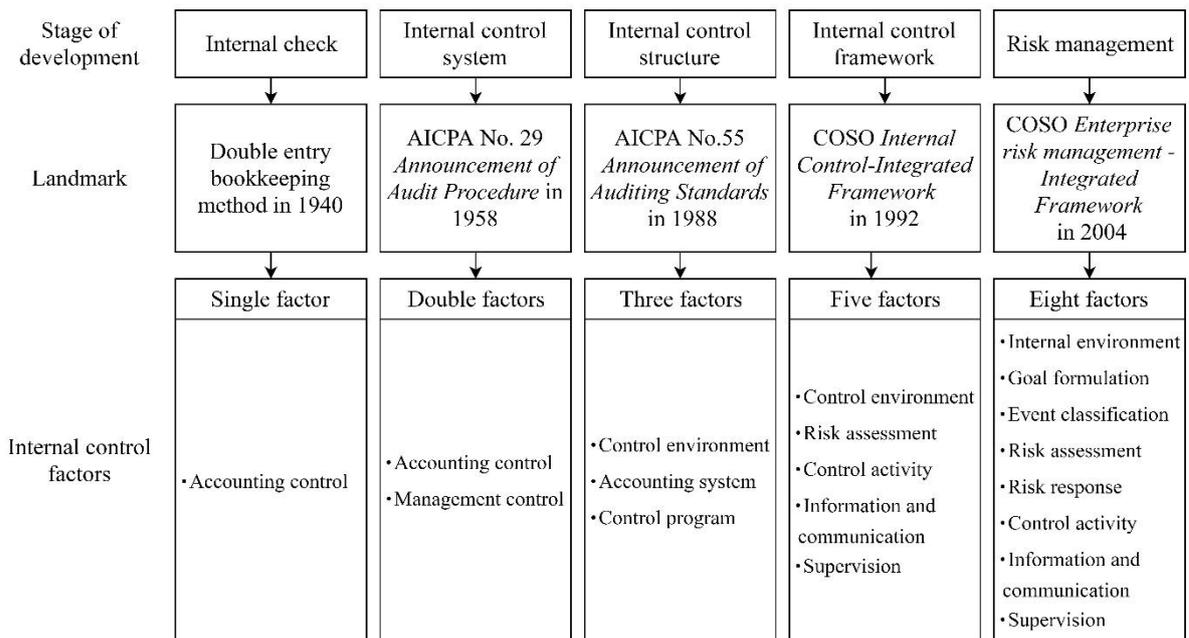
## **2.2. Theoretical Research of Internal Control**

Giriunas and Giriuniene (2010) [1] pointed out that efficient business management is an indispensable element for unit organizations under the conditions of fierce competition. And efficient modern corporate management needs to build a perfect internal control system, internal control is a means of corporate management and tools. The author emphasizes the influence of internal control on corporate management. Yang (2012) [2] considered that corporates should disclose internal control information to the public for public supervision through studying the impact of SA act on corporates and comparing relevant experimental data, which could enhance and ensure the authenticity and reliability of corporate financial information. Musgray, Jeffrey L.(2015) [3] pointed out that internal control has a comprehensive principle, which is embodied in the whole operation and management activities of an corporate from policy making to implementation to supervision, and that the realization of strategic objectives, decision-making, economic benefit improvement and corporate property protection of an organizational unit can be achieved through the internal control system.

Yu Erli (2010) analyzed the internal control environment and the mode of internal control, and believed that the internal control environment, in a broad sense, was composed of internal environment and external environment. The internal control mode was composed of "soft" control and "hard" control, and the control environment could also be divided into "soft" environment and "hard" environment along with the control mode. Mei Shuxian, Zeng Wei and Li Hongzhi (2015) analysed Chinese corporates and sorted out their internal control problems and causes. The author pointed out that the internal control problems of corporates mainly lie in the deviation of understanding of internal control system, weak risk awareness of senior management, inadequate supervision and incomplete internal control framework. Zheng Panpan (2019) [4] analysed the connotation of the modern corporate financial risk, from two aspects of internal and external illustrated the reason of the financial risk, mainly including corporate decision-making mistakes, insufficient financing activities, ignore the impact of national policy for the corporate, then explained the financial risk evaluation consists of debt paying ability, operation ability, profitability and development capacity, the four aspects, and put forward countermeasures for the modern corporate financial risk management problems.

In a word, foreign scholars have formed a relatively perfect internal control theory system in the research on internal control, and most of the research is on the basis of the COSO report five elements theory. However, most domestic studies on internal control of Chinese corporates are based on internal control theory and combined with the actual situation of

corporates, but these studies do not pay attention to risk control and financial control. In order to solve this problem, this paper starts from the internal and external environment, and constructs the corporate health index combining risk and financial control to measure the quality of corporate internal control.



**Figure 1** The development of international control

### 3. MODEL BUILDING OF CORPORATE HEALTH INDEX

In September 2017, COSO officially released the updated version of Corporate Risk Management Framework, which redefined risk, believing that risk is the possibility that events occur and affect the realization of strategic and business objectives. The definition emphasizes the double-sided impact of risk, instead of only emphasizing the "negative" of risk. COSO framework evaluates the combination of strategy and risk from three different aspects. One is the possibility that strategy is inconsistent with corporate mission, vision and core values. Second, the risk connotation of the selected strategy; Third, risks to strategy and performance. The risk performance curve based on COSO framework puts forward the methodology of risk performance quantification analysis, but there is no uniform standard for corporate risk quantification method. Therefore, in order to solve this problem, this study combined with the internal control and risk management theory, based on the 2017 version of the COSO framework, combined with the company "strategic - risk - performance" three dimensional health index model to realize the integration of the concept of comprehensive risk management and corporate management in all aspects and provided practical guidance for the formulation of corporate risk management objectives, system implementation and evaluation.

#### 3.1. Model Building of Health Index

According to the goal and meaning of corporate health index model, fully considering the state-owned assets supervision and administration commission of the central corporate integrated performance evaluation, corporate boards to standard, assets management evaluation system framework for target, we establish a risk management oriented corporate health index model, divided into internal control overall evaluation and financial evaluation, strengthen the concept of risk management throughout the whole process of business activities, from the risk control, operation and management to double support index framework, effectively balance the relationship between corporate strategy, business performance and risk control, fully displaying corporate health.

We take the corporate health index model for evaluation tools, use the company's internal control to evaluate specific work, considerate comprehensively the relationship between "strategy, performance, risk", have built a whole process and quantifiable internal control integrity evaluation system, which specifically includes quantitative evaluation of the company's overall risk guarantee coefficient and quantitative evaluation of comprehensive management, mainly

integrating the forms of SASAC comprehensive performance evaluation, asset management performance benchmarking, financial evaluation and performance evaluation.

Internal control overall evaluation = overall risk security coefficient \* comprehensive management ability. overall risk security coefficient of the evaluation results in the form of greater than zero, the percentage of less than 100%, comprehensive management ability in the form of greater than zero and less than 100 score and multiplication scoring can highlight multiplier effect to the guarantee of the operation and management, risk control and be easy to use.

Indicator system. In terms of index setting concept, based on the goal of cultivating world-class corporates and the company's vision of "two first-class", it puts forward first-class risk control and management level and operation and management ability, and sets two quantitative indexes, the overall risk guarantee coefficient and the comprehensive operation and management ability.

Overall risk security coefficient of quantitative indicators to ensure the implementation of corporate value, improve risk control capability, based on the 2017 version of the COSO risk management framework and the five elements of internal control management of the fused, set up the internal environment, risk, control action classes, risk control effect and risk information and class level indicators, and according to the Ministry of Finance, state-owned assets supervision and administration commission, the board of supervisors each risk control work deployment of refining the secondary indexes, reflects the comprehensive risk prevention and control of the corporate and grasp opportunities. Operating results of quantitative indicators to state-owned corporates as the research object, combining the requirements for the performance evaluation of state-owned assets supervision and administration commission, SASAC, at the same time give full consideration to the corporate long-term business objectives and short-term relationship management goal, in order to enhance the value of the company to create leading ability as the main line, setting up a safe and reliable, customer service, product quality, market share, profitability, cost growth ability, growth ability, innovation first-level indicators, eight aspects corporate reflects the comprehensive performance management ability.

##### 3.1.1. Financial Evaluation

The financial evaluation is divided into two parts: financial operation and management ability and financial risk guarantee coefficient. Based on the dual responsibilities of "value creation" and "risk management", the overall measurement of the

company's sustainable value creation ability is carried out based on the financial report data to clarify the relationships between final accounts, audit, evaluation and budget, and provide comprehensive, real and reliable data support for product pricing, budget arrangement and business management.

Model formula. Financial evaluation = financial risk guarantee coefficient \* financial operation and management ability, the range of financial risk guarantee coefficient is 0-100%; Financial management ability score between 0-100 points. Multiplicative scoring can highlight the multiplier effect of risk on financial performance and the important role of risk in financial management. At the same time, the operation in the calculation process is simple and easy to execute.

Indicator system. Financial operation and management ability sets evaluation indexes from five aspects, namely asset quality, debt paying ability, cost control, pricing management and operating benefit. It mainly integrates financial performance evaluation, SASAC comprehensive performance evaluation of central corporates and other evaluation system indexes, and the evaluation results can be displayed in multiple dimensions. The quantitative indexes of financial risk guarantee coefficient are set from eight aspects, including capital, project assets, accounting information, pricing management, cost budget, property rights, finance and taxation, and cost supervision and examination. The financial risk is evaluated from the evaluation dimension of problem growth ratio and rectification completion rate.

**3.2. Evaluation Criterion**

Referring to the rating methods of Moody's and Standard & Poor's, the health index of each unit is divided into five grades of AAA -B by the five-fifths distribution method, representing the overall health level from high to low.

**Table 1 The specific classification**

AAA ( $84.01 \leq X \leq 100$ ) : Health	The corporate is in very good state in operation management and risk control, with a small amount of extremely slight risks.
AA ( $63.01 \leq X \leq 84.00$ ) : Slight Health	The corporate is in good state in operation management and risk control, with some slight risks.
A ( $37.01 \leq X \leq 63.00$ ) : Sub-health	The corporate is in a normal state in operation management and risk control, with certain medium risks, which should be strengthened in term of control.

BB ( $6.01 \leq X \leq 37.00$ ) : Less Health	The corporate is in a poor state in operation management and risk control, with certain significant risks, which need to be further improved as a whole.
B ( $0 \leq X \leq 16.00$ ) : Unhealth	The corporate is in a poor state in operation management and risk control, with certain major risks and some catastrophic risks, which is in urgent need of improvement on the whole to ensure its sustainable operation.

**4. SUMMARY**

Based on the theory of corporate health index, this paper has realized the evaluation of corporate health, which has made great progress in both theory and practice. However, there are still some problems that are not fully considered and need to be further studied in the future. Facing the future, we should further study and explore the following two aspects: improving the rationality of design. The rationality of evaluation index contents, calculation methods, evaluation methods and measurement methods should be verified based on the data of each company. Meanwhile, the different analysis should be conducted in depth to constantly adjust indexes and build an accurate index system. By using the existing risk control information system, the health index of provincial and municipal corporates is input into the system to realize the automatic operation of the evaluation system and simultaneous display of evaluation results. At the same time, it makes a comprehensive and multi-angle analysis of the health index scores of online corporates by means of informatization, so as to provide timely and effective data for the company's business decisions and promote the healthy and orderly development of the company.

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