



# Research on Internal Control of Listed Companies—— A Case Study of CITIC Investment Corporation

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## ABSTRACT

Internal control is an important aspect of the transparency construction of Chinese enterprises. The purpose is to enhance the internal management level of enterprises and the ability to resist market risks. In recent years, many securities companies in China have closed down or been entrusted by other large companies, which shows that there are still many problems to be solved in China's securities market enterprises. This paper analyzes the current situation of internal control of CITIC Securities in detail. Therefore, the study of the internal control of the securities industry also has a profound guiding significance for the construction of the internal control system of Listed Companies in China.

**Keywords:** *Internal control; CITIC Securities; Company; Risk management; Securities industry Corporate governance structure; Information disclosure*

## 1. INTRODUCTION

In the past practice, many securities companies feel that internal control is not conducive to the innovation and development of enterprises, and in the actual business, they do not pay attention to the prevention of financial risks and ignore the construction of enterprise internal control. Then, how to improve and establish the internal control system of the securities market is a very important topic. Strengthening the ability of market restraint, so as to resolve financial risks and promote the modernization of China's enterprise system has become a key topic of great concern to the managers of securities enterprises.

## 2. LITERATURE REVIEW

### *2.1 literature review of theoretical basis at home and abroad*

#### *2.1.1. Definition of internal control*

Wang Hong (2008) believes that internal control refers to a management system process with clear rights and responsibilities, strong checks and balances and dynamic improvement in order to improve the efficiency of enterprise business risk management, ensure the authenticity and reliability of accounting information service quality, protect the safety and integrity of assets, promote the effective compliance with China's laws and

regulations, and realize the China strategy of economic development [1].

#### *2.1.2. Importance of internal control to the company*

First, it is conducive to strengthening the philosophy of enterprise managers and the business style of enterprises, which enables managers to take active measures in the face of business risks. Second, it is beneficial to establish the concept of enterprise integrity and morality. Third, there is time for the scientific nature of enterprise internal management. The establishment of the internal control system requires the interdependence of the board of directors and the audit committee [2].

### *2.2. Factors determining enterprise internal control*

#### *2.2.1 Internal factors*

Ge and MC vay (2005) found that the disclosure of major defects is positively correlated with the complexity of enterprise operation and negatively correlated with enterprise scale and profit [3].

#### *2.2.2 External factors*

Liu Qiliang et al. (2012) found that in general, the

quality of internal control of companies controlled by local governments is poor [4].

### ***2.3 Literature review of internal control of domestic listed companies***

#### ***2.3.1 current situation of internal control of listed companies***

With the continuous improvement of China's laws and regulations on enterprise internal control management, regulators have gradually paid more attention to the implementation of internal control system by listed companies. China's listed companies have also begun to actively improve the internal control system, and the internal control level of China's listed companies has improved year by year.

In 2021, a total of 2340 listed companies were selected from the companies listed on the Shanghai and Shenzhen stock exchanges, and 1844 companies in the company development disclosed the evaluation report on the effectiveness of the internal management control system. Among them, the internal control evaluation reports disclosed by 1841 companies showed effectiveness without major defects in internal control. The internal control effectiveness of all enterprises that disclosed internal control accounted for 99.8%. Therefore the internal control level of China's listed companies has improved year by year.

## **3. CASE ANALYSIS - TAKING CSC SECURITIES AS AN EXAMPLE**

### ***3.1 Introduction to CITIC securities***

CITIC Securities was founded in 1995 and began to issue a shares in 2002. In 2017, the company could realize an operating cost income of 43.3 billion yuan, a net profit of 11.4 billion yuan, a return on investment in net assets of 7.82%, and its income and net profit ranked first in China's domestic market. CITIC Securities has a complete set of internal management departments, but the violations of laws and disciplines led by the general manager in 2015. Therefore, to study internal control, we must deeply understand the function implementation of each department of the enterprise, so as to find the deep-seated problems of CITIC Securities and then find solutions.

### ***3.2 problems and analysis of internal control of CITIC Securities***

#### ***3.2.1 analysis of supervision problems of internal control***

##### **1. Supervision of internal control**

The regulatory mechanism is the main reason for the

regulatory problems. According to the survey, half of the companies do not have an internal audit department, and none of the companies that have established an internal audit department have played their regulatory functions. In addition, from the perspective of the internal audit function of CITIC Securities, the evaluation of the perfection of the internal control system and the efficiency of each organization in the enterprise in performing the specified functions failed to play its corresponding functions.

#### **2. Analysis of internal control supervision**

##### **(1) Insufficient deterrence to enterprises**

Because the financial departments, tax authorities, audit departments, banks and other social supervision institutions do their own work, the standards set are not unified, and the management is scattered and the communication is lack, so a comprehensive supervision and management has not been formed.

(2) The audit department did not pay enough attention to the three "regularization" (regularization, standardization and legalization) of audit).

(3) In the punishment of the problems found out, it is often big and small, avoiding the heavy and seeking the light, distorting the rigidity of law enforcement. At present, China does not have a binding and supervising external mechanism to motivate managers, so that managers do not have more pressure and have little improvement on themselves.

#### ***3.2.2 analysis of internal control problems***

##### **1. Low risk awareness**

CITIC Securities has a very low risk awareness. Among the many risks faced by CITIC Securities, they must establish a mechanism to distinguish and manage risks, and establish high-risk areas to strengthen the supervision of enterprises. From the current situation of CITIC Securities surveyed, there are common problems such as insufficient understanding of the situation and market, overconfidence and optimism, blind expansion hypothesis and so on.

##### **2. Unreasonable risk assessment**

According to the investigation, there are great problems in the integrity of control and the effectiveness of implementation. For example, no one knows who keeps all the seals, and the use is lack of supervision, approval management and any use records. This situation may bring potential business risks to the company.

### *3.2.3 information disclosure and problem analysis of internal control*

#### 3.2.3.1 information disclosure of internal control

##### 1. Internal control self evaluation report

Summarize and disclose the internal control construction of CITIC Securities Based on the five elements of internal control. For the specific content of disclosure, the self-assessment report was clearly reported in 2013. The content of the internal control self-evaluation report disclosed in 2014 is more logical and rigorous, but several major violations of law and discipline occurred in CITIC Securities in 2015. Therefore, the self-evaluation report in 2015 mainly includes a comprehensive evaluation of the company's internal control from the five elements of internal control, clearly emphasizes the important role of internal control, and announces the defects of internal control in non-financial information for the first time.

##### 2. Internal control audit report

In the 2015 audit report, the normative information of securities accounts disclosed in the previous year was cancelled, and the length was short. This shows that internal control audit has gradually been paid attention to. The 2016-2017 internal control audit report is more comprehensive, covering almost all aspects of internal control.

##### 3. Annual financial report

Great changes have taken place in the form and content of internal control information in the annual reports issued by CITIC Securities from 2013 to 2017. Although CITIC Securities disclosed the construction of internal control in its 2015, 2016 and 2017 annual reports, there were significant differences in the contents disclosed by CITIC Securities in 2013 and 2014. In 2013, the contents of internal control system, internal supervision, overall plan of supervision and self-evaluation of internal control contents were added. This shows that the internal control information disclosure of CITIC Securities is constantly improving.

#### 3.2.3.2 analysis of information disclosure of internal control

##### 1. Unreasonable ownership structure

The nature of controlling shareholders and ownership concentration are the main factors affecting the ownership structure in enterprises. The high concentration of equity will lead to the supervision and control of the use right by the major shareholders, which could damage the economic interests of other shareholders. Among CITIC Securities, the equity concentration is high because its two major shareholders are Hong Kong Central Clearing Co., Ltd. and CITIC Co., Ltd., which are directly under the

management of the State Council.

##### 2. Unreasonable ownership structure

The nature of controlling shareholders and ownership concentration are the main factors affecting the ownership structure in enterprises. The high concentration of equity will lead to the supervision and control of the use right by the major shareholders, lead to the collusion between the management and the controlling shareholders, and damage the economic interests of other shareholders. Among CITIC Securities, the equity concentration is high because its two major shareholders are Hong Kong Central Clearing Co., Ltd. and CITIC Co., Ltd., which are directly under the management of the State Council and the Ministry of finance. The shareholding structure of CITIC Securities was the largest among the state-owned enterprises, accounting for 18.79% in 2017. The proportion of the top ten shareholders exceeds 50%, which improves the strong level of CITIC Securities, which also ignores the interests of minority shareholders.

##### 3. The rights of the board of supervisors are weakened

Even if CITIC Securities had a board of supervisors and a board of directors, the case of "eight executives being investigated" still occurred in the internal control disclosure event in 2015.. Afterwards, CITIC only recognized the information disclosure of the internal control defects of the board of directors. This also reflects that the internal risk control mechanism of CITIC Securities is not perfect, and the board of supervisors does not play the responsibility of efficiently supervising the board of directors and management of the company, thus allowing risks to occur and causing significant losses to the company.

4. The information disclosure initiative of the management is not strong

The management of listed companies is the key person of the whole company, but most of them lack the awareness of internal control. Most management believe that internal control is an abstract concept and has no substantive role. Therefore, they chose not to disclose. If enterprises disclose relevant internal control information in accordance with the requirements of the CSRC, it may bring potential significant risks to the company and bring a lot of negative effects to investors. Therefore, disclosure is excluded. The factors affecting the information disclosure awareness of CITIC management should be dominant.

### **3.3 suggestions on strengthening the construction of internal control of CITIC Securities**

1. Improve the internal governance structure of the company

First, the company should first adjust its ownership

structure and ownership structure, and let private capital participate in the operation of the securities industry, so as to create the efficiency of the company's operation and management and internal control. By expanding the shareholding ratio of non-state-owned shareholders, give full play to the supervision and balance function of ownership structure.

Second, CITIC Securities should give full play to the functions of the board of directors and independent directors and should clarify the governance objectives, increase the proportion of independent directors in the board of directors, and strengthen the supervision mechanism of the board of supervisors.

Thirdly, CITIC securities industry should further ensure the independence of the board of supervisors, so as to improve the independence of the board of supervisors on the board of directors. We should clarify the rights and accusations of the board of supervisors and fully mobilize the enthusiasm of the members of the board of supervisors.

#### 2. Improve the incentive mechanism of internal control information disclosure

The management believes that the disclosure of a large amount of internal control information will increase the cost of internal information and have a certain impact on the development of the company. For citic securities, the establishment of an anonymous reporting system for internal control defects, and the establishment of higher incentive funds, in order to improve the enthusiasm of internal staff supervision and better find the internal problems of the company.

#### 3. Strengthen internal control information disclosure of special risks

We should improve the level of enterprise information disclosure and strengthen the supervision of information disclosure. For citic securities, the perfect internal control mechanism must dare to disclose the special risks existing in the company. These special risks may predict the difficulties that may be encountered in the future in advance.

## 4. CONCLUSION

### *4.1 suggestions and Countermeasures to improve the internal control of Listed Companies in China*

#### 1.Improve the internal control environment.

The efficiency of the internal control environment is the guarantee of effective implementation of internal control in enterprises. The company should improve the role of independent directors and strictly limit the appointment of chairman and general manager to avoid management's discretionary behavior without legal supervision.

#### 2.Improve the risk assessment system

Listed companies should raise their awareness of risk prevention, set up special risk management departments, introduce senior risk management personnel, and clarify the objectives of risk management, so as to distinguish risks in various aspects of the enterprise and propose targeted risk response plans.

#### 3.Strengthen the implementation of internal control.

For the relevant control system established by the enterprise, the corresponding department is responsible for adjusting it according to the development of the enterprise to ensure the operability of the system. At the same time, the responsibility of the government to implement penalties and the responsibility of the internal control system is clarified.

#### 4.Strengthen the exertion of supervision function.

Listed companies set up a special internal audit organization. In addition, there is a need for pre-audit and audit-in-fact, which will help senior management to properly evaluate the appropriateness of risk management strategies and systematically identify the risks faced by the enterprise.

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