

# Research on the Optimization of the Internal Control System of Small and Medium Sized Enterprises in China

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**Abstract.** With the deepening of the Reform and Opening up, small and medium sized enterprises play a rather important role in China's economic development, absorbing the social labor force, the maintenance of social stability and other aspects. By analyzing the present situation of the internal control of small and medium sized enterprises in our country, this paper finds out a series of problems existed in the process of internal control. And then put forward countermeasures and suggestions for the optimization of the internal control system in small and medium-sized enterprise from the four aspects of setting up the human centered business philosophy, establishing the guiding ideology of the management, creating unique enterprise culture and building a scientific and complete internal control mechanism.

## 1. Introduction

Since the Reform and Opening up, China's small and medium-sized enterprises play a rather important part in the development of national economy. Their utility in maintaining national economic growth and maintaining social stability is becoming more and more obvious. According to statistics, by the end of 2008, China's small and medium enterprises accounted for more than 90% of the total number of domestic enterprises; the absorbed social workers occupy more than 80% of enterprise employees; the completed operating income is 69% of the total revenue of domestic enterprises, its contribution rate to the growth of the operating income of domestic enterprises is up to 98%. It can be seen from the above that the small and medium-sized enterprises are the main force in the development and construction of national economy. The economic situation of small and medium-sized enterprises is directly related to the development level and construction of China's economy. With the continuous deepening of the reform of domestic market economy system, the market competition that China's small and medium-sized enterprises are facing is increasingly fierce. In the new market environment, in order to realize the sustained and healthy development, small and medium-sized enterprises need to attach great importance to the optimization of the internal control system.

## 2. Present situation of the internal control of small and medium sized enterprises in China

### 2.1 The implementation of internal control in small and medium sized enterprises

At present, China's small and medium-sized enterprise has obtained good effect in the process of internal control. Especially in the three projects of cash flow, payment of the purchase and sales and money collection, 60% of the small and medium-sized enterprises have strict internal control. This shows that although the domestic small and medium-sized enterprises do not have the formal internal control mechanism as large enterprises, the effect of the implementation of internal control is not worse than that of the large enterprises. In addition, small and medium-sized enterprises have obvious control effect in the budget control, authorization and approval control, accounting system control and other aspects. However, the control effect is not so obvious in the aspect such as network information technology control, property preservation control, and risk control. From the effectiveness of internal control, at present, only 30% of small and medium-sized enterprises believe that internal control has a great effect on the development of enterprises. The effect of internal control is embodied in ensuring the integrity and safety of enterprise assets, ensuring the reliability and authenticity of the financial data of the enterprise, ensuring that the scope of business operation is in accordance with the relevant laws and regulations, and ensuring the smooth

operation of the business of enterprises.

## 2.2 The environment of the internal control in small and medium sized enterprises

Through the investigation of the environment of internal control in 80 small and medium-sized enterprises in China, it can be seen that in 62.50% of small and medium-sized enterprises, the chairman and general manager are not the same person, which shows that more than half of the domestic small and medium-sized enterprises have made a separation of the management right and ownership. In this way, the management will be more efficient in making business decision and will be more flexible when it responses to the market change. And thereby the development of enterprises can be better promoted. However, 37.50% of small and medium-sized enterprises did not realize the separation of the management right and ownership. The pattern of "the unification of the management right and ownership" is a major feature of the development of domestic small and medium sized enterprises. However, with the gradual expansion of small and medium-sized enterprises, this pattern is likely to restrict the development of enterprises. In the aspect of the implementation of the unified code of conduct, 71.25% of small and medium-sized enterprises have implemented a unified code of conduct. This shows that the majority of domestic small and medium-sized enterprises are committed to building a set of internal control mechanism to regulate the operation. In addition, 78.75% of small and medium-sized enterprises provide employees with opportunities of training and further learning. This indicates that most of the enterprises are continuously strengthening the management and control of the quality of the staff. At the same time, 57.50% of small and medium-sized enterprises constantly improve staff incentive mechanism. It can be seen that staff motivation is playing a more important part in the internal control of enterprises.

Table 1: Statistics of the internal control environment of SMEs

Item number	project	Yes		No	
		Number of enterprises	percentage	Number of enterprises	percentage
Item 1	Whether the chairman or general manager is the same person or not	30	37.50%	50	62.50%
Item 2	Whether the unified code of conductor is implemented or not	57	71.25%	23	28.75%
Item 3	Whether the learning and training opportunities are provided to the employees or not	63	78.75%	17	21.25%
Item 4	Whether there is a sound staff incentive mechanism or not	46	57.50%	34	42.50%

## 2.3 The monitoring status of internal control in small and medium sized enterprises

In essence, the internal control of the enterprise is dynamic, rather than static. The internal control system will change at any time according to the change of the event. In order to better ensure the effective operation of the internal control system, enterprises need to make a close monitor of the internal control system. According to the statistics in table 2, we can know the monitoring status of the internal control in domestic small and medium-sized enterprises. Among the investigated 80 small and medium-sized enterprises, 56 enterprises did not set up a special internal audit system, the proportion was 70%. It can be seen that the majority of small and medium-sized enterprises did not set the corresponding internal audit departments in order to reduce the cost of enterprise. Or they may consider that the internal audit department does not have much effect in the internal control system of enterprises. There are 49 enterprises which do not regularly

evaluate the internal control effect, and the proportion is 61.25%. This proportion shows that more than half of the small and medium-sized enterprises may have deviation or delay in the implementation of internal control. However, among the 80 small and medium-sized enterprises, 50 of them can modify the parameters of the internal control system in time, and the proportion is 62.50%. This shows that small and medium-sized enterprises have a positive attitude in the monitor of internal control, and 68 companies considered that detailed internal control guidelines are supposed to be prepared for enterprises.

Table 2 The monitoring status of the internal control in SMEs

Item number	Project	Yes		No	
		Number of enterprises	percentage	Number of enterprises	percentage
Item 1	Whether the special internal audit system is set up or not	56	70.00%	24	30.00%
Item 2	Whether the effect of the internal control is evaluated regularly or not	49	61.25%	31	38.75%
Item 3	Whether the parameters of the internal control system is modified in time or not	30	37.50%	50	62.50%
Item 4	Whether the guidelines for the internal control is compiled in detail or not	12	15.00%	68	85.00%

### 3. Problems existed in the internal control of small and medium sized enterprises in China

The internal control system of small and medium-sized enterprises is a general designation of various measures and methods that have the effectiveness of control. It includes a series of measures to ensure the normal operation of economic activities. The construction of the internal control system of small and medium-sized enterprise is to ensure the integrity and safety of enterprise assets, to ensure the real and legality of the operating procedures and policies of enterprises, and timely discover and correct the mistakes existed in the process of business operation. The internal control system of small and medium enterprises can be divided into accounting control system and management control system according to its characteristics. These two control systems run through every link of the enterprise's economic activities. Therefore, they cannot be treated as the rules and regulations of the enterprise. At present, the internal control system of domestic small and medium-sized enterprise is not perfect, and the economic benefit and operating efficiency of enterprises is still relatively low. The reasons are as follows:

#### 3.1 The internal control idea of the management of small and medium-sized enterprise is not high

In essence, most of the domestic small and medium-sized enterprises are family enterprises or private enterprises. The management mode is self determined, and all rights are mastered in their own hands. They consider that they can deal with everything in a good way through their own management. Thus, it is not necessary to spend money to employ additional management personnel or to construct the internal control system of the enterprise. At present, some small and medium-sized enterprises have realized the necessity of setting up the internal control system. However, they still have the idea of trusting to luck. Hence, they will ignore the construction of prevention system, and only to regulate the corresponding measures after the crisis. In addition, some small and medium-sized enterprises have begun to plan the construction of internal control system. However, due to the limitations of their own ability, they often cannot fully aware of the internal characteristics of the enterprise, which will result in the situation that they cannot make the

corresponding adjustment according to the actual situation in China to achieve the development keeping up with the times.

### **3.2 The internal control system of small and medium-sized enterprise is not perfect**

At present, the internal control system in most of the domestic small and medium-sized enterprise is not perfect, which cannot fully cover the internal mechanism and staff of the enterprise. The development of various departments of the enterprise is uneven in quality. Especially the accounting department of the enterprise, due to its unclear internal division of labor and the imperfect governance structure, the internal operation department of small and medium-sized enterprises often appear the phenomenon of data distortion. If the small and medium-sized enterprises lose the control function to the internal function department, they cannot obtain the effective information from the operation process. Then, the effectiveness of the internal control of small and medium-sized enterprise will be greatly reduced. From the financial department of small and medium-sized enterprises, at present, many enterprises have not established a sound financial control system yet. The accounting, cashier, and even to the financial audit of the enterprise are did by the same person. Therefore, behaviors such as the false report of the profit, malicious evasion and data falsification often appear in the operation of enterprises. The reason is that the internal control system of small and medium-sized enterprise is not perfect, and loopholes exist in the process of the operation of enterprises.

### **3.3 The small and medium-sized enterprises lack the scientific internal supervision system**

The internal supervision system of small and medium enterprises can be divided into special supervision and continuous supervision. At present, the small and medium-sized enterprises are restricted to the personnel and scale, and the information communication is not smooth. These make the two kinds of internal supervision system lack of scientific. In the process of special internal supervision, some small and medium-sized enterprises have not set up the corresponding internal audit system. Even though some enterprises have set up internal audit institutions, the functions of enterprises have been correspondingly weakened in the process of practice, which will affect the effectiveness of the internal control of enterprises. In order to further improve the implementation of the internal management system of small and medium-sized enterprises, most of the enterprises have made corresponding improvement and exploration of their internal supervision mechanisms. However, the staff of the small and medium-sized enterprises does not pay much attention to the internal supervision mechanism, and the quality of the staff who implements the internal supervision is not high. This makes the supervision effectiveness of the internal supervision system of small and medium-sized enterprise is not obvious.

## **4. The optimal path of internal control system of small and medium sized enterprises in China**

### **4.1 Set up the operation idea of human centered**

Managers of small and medium-sized enterprises need to continuously guide the staff and workers, and help them realize their effect on the development of the enterprise. At the same time, employees should also contribute to the sustainable development of enterprises. In addition, it is necessary to make employees realize their own value, and enhance the employee's sense of identity and the sense of being respected. This can effectively stimulate the initiative and enthusiasm of the staff in the working process. In the process of internal control of small and medium-sized enterprises, the supervision right of financial department is greater than other functional departments of the enterprise. Therefore, employees of the financial department bear more significant responsibility in the implementation of the supervisory functions of the enterprise. Hence, enterprises must conduct the screening of the ability and accomplishment of the staff before they start working. At the same time, it is also necessary to set up the reserve system of professionals and construct the learning organization. Under this circumstance, when opportunity comes, small and medium-sized enterprises can fully grasp the opportunities for the development without affecting the daily operation and management of the enterprise.

#### **4.2 Establish the guiding ideology of management**

The management of the enterprise refers to the management activities implemented by the enterprises based on the operational objectives in order to ensure the normal production, operation and financial business of the enterprise. The ideology of economic management refers to the essential and systematic guiding ideology and management guidelines which are established to maintain the harmonious relationship between enterprise and customers, between enterprise and enterprise, between enterprises and the government. It is constructed on the basis of the concept of operation, the values and the trend of the development of the enterprises. In the process of establishing the guiding ideology and the management of guiding mechanism, it is necessary to divide functions such as the making of strategic decision, development decision, financial decision, and public relations decision, and provide the corresponding support. After establishing the corresponding management guiding ideology, it is also necessary to link up the internal management of the enterprise with the production operation, to strengthen the construction of the internal control system of the enterprise, and to take the construction of the internal control system of the enterprise as the dominant idea of the management of the enterprise.

#### **4.3 Create unique enterprise culture**

Enterprise culture is formed in the process of the production management and operation of the enterprise. It is a mixture of material and spiritual wealth with the characteristics of the enterprise. It includes the values, the culture view, the historical view and enterprise spirit of enterprises and so on. The enterprise culture has a certain guiding effect on the management activity and the practical production activity of the enterprise, and it is also observed and approved by the staff of the enterprise. In the process of creating the enterprise culture, small and medium-sized enterprises need to combine the direction of the development and the internal characteristics of the enterprise to create a unique enterprise culture mode. Small and medium-sized enterprises also need to use enterprise culture to create more convenient conditions for the internal control of enterprises, and constantly stimulate the enthusiasm of the workers of the enterprise. It is necessary for enterprises to rely on the enterprise culture to constantly inspire employees' sense of responsibility and sense of mission, and constantly strengthen employees' sense of belonging, strengthen the impact of enterprise culture, and ultimately make the enterprise culture constantly changing into the productivity of the enterprise.

#### **4.4 Construct a scientific and complete internal supervision system**

Small and medium-sized enterprises should establish a sound internal supervision system, and establish the standard legal person management mode, so as to form the balance of the decision-making, implementation and management. It is necessary to increase the intensity of information disclosure in the regulation, and ultimately realize the sharing of the information of various departments, and realize the transparency of the operation process. The establishment of internal supervision system needs to relate to the characteristics of the development stage of the small and medium-sized enterprises, reasonably adjust the supervision, and give enterprises corresponding independent rights in the process of the implementation of the supervision. The construction of the scientific and complete internal supervision system is to ensure the smooth development of the operation and management activities of enterprises. Therefore, it is similar to the daily management activities of the enterprise. It is a continuous development process. It is worth mentioning that enterprises cannot abuse the regulatory authority of the enterprise or impede the normal operation of the enterprise in the process of the construction of the internal supervision system. Once there is bad use of the right, the feedback should be in time, and corresponding improvement measures should be taken, so as to help enterprises to obtain a higher operational performance.

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