

Research on the Internal Control of Small and Medium Manufacturing Enterprises under Comprehensive Risk Management

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Abstract: This paper has combed the research results on internal control of small and medium manufacturing enterprises of domestic and foreign scholars. Combined with the status analysis of internal control and risk management of small and medium manufacturing enterprises, this paper built the internal control framework of small and medium manufacturing enterprises based on comprehensive risk management in order to improve the system of internal control theory and provide reference to small and medium manufacturing enterprises in China.

Keywords: Comprehensive risk management; Small and medium manufacturing enterprises; Internal control

1 Introduction

The research of internal control has a relative remote origin. In 1949, the US CAPO first proposed the concept of internal control. In 1992, the US COSO promoted the concept and elements of internal control in its report "Internal Control- Integrated Framework". COSO published "ERM-IF" in 2004, and made the internal control and enterprise risk management closely integrated by breaking the previous limitations of internal control.

Research on internal control in China began in 1980s. The researches on internal control of small and medium manufacturing enterprises are not so many, most of them are concentrated in how to improve the internal control. For example, Zong Xiusong (2006) thought that there are many problems in the internal control of small and medium manufacturing enterprises now, such as deficiency in understanding of internal control, lack of constraints in the mode of management, and lack of effectiveness of internal control objectives, so the enterprises need to strengthen the moral training and the education of internal control system of all staff, establish an effective internal control system with the actual and strengthen supervision. Zhang Wei (2004) suggested that the internal control issues for SMEs included weakness of the internal audit function, so the enterprises need to strengthen the audit of internal control. Lu Bingqing (2007) studied the existing problems in small foreign manufacturers from the organization structure, internal control systems, and internal control mechanism in business process.

Limited to the internal control systems and internal process, most studies neglected the organic combination between internal control and risk management, and the internal control in enterprises today can not play well in reducing the risks. Therefore, based on the comprehensive risk management, this paper builds internal control framework analyzing the status of internal control and risk management of small and medium manufacturing enterprises, so as to provide a reference to small and medium manufacturing enterprises in China.

2 Analysis of the Status of Internal Control and Risk Management of Small and Medium Manufacturing Enterprises

2.1 The awareness of risk management is not strong

(1) Weak risk identification ability. Most small and medium manufacturing enterprises is private enterprises. For the majority enterprises are growing up in family businesses, enterprises' managers are mostly experienced management. Their management abilities and qualities can not keep up with the economic development and market changes. Due to insufficient knowledge management theory, most of them can not identify potential risks inherent in business by standing in the overall and strategic perspective.

(2) Lack of financial control. Manufacturing enterprises involved in many kinds of business, such as procurement, manufacturing and sales. These complex businesses often lead to the unreasonable budget, the waste of unnecessary expenditure, and bring some financial risks to the enterprise. In addition, the saving of the manufacturing enterprises' cost is directly equivalent to an increase of revenue, while high cost of investment means high risk in the recovery of funds. Because of the lack of human and financial resources, SMEs haven't set up a complete set of cost management mechanism to

reduce risks.

(3) Personnel quality control is not in place. Frankly speaking, enterprise risk management is management to people, as all activities of enterprises are implemented and operated by people. The majority of China's manufacturing industry is state-owned enterprises. As the protection of "royal" relationship, the personnel are uneven in quality. And it brings some risks to enterprise's management.

2.2 The construction of workflow system is not perfect

(1) Too many steps in the process. The current division of small and medium manufacturing enterprises is too small to make that the completion of a business process requires a lot of departments' assist. The communication between different departments is difficult for the independent and the slow information flow of departments. So it is difficult to ensure that the enterprise can complete products customers need in the specified time.

(2) The mandatory lack of the process implementation. A common problem in most enterprises is that the definitions of roles and responsibilities of sectors are not clear, and small and medium manufacturing enterprises are no exception. There is no unified standard in enterprises. And it leads the operation duplication of some parts of the workflow, the waste of resources, and the financial risks of enterprises.

(3) The key processes are not linked with the performance. Generally, most small and medium manufacturing enterprises are production-based, and don't have the capacity of independent R&D. So the needed staff qualifications and the wages are relative low. The key processes of production line are not linked with the performance leads the low employee motivation, the frequent job-hopping and the phenomenon of "labor shortage", and risks of increasing human resource costs.

2.3 The organizations are unreasonable

(1) High levels and small amplitude of management. Now, small and medium manufacturing enterprises in China are still in the status of extensive management. The enterprise scale is not large, and most businesses decisions are made by the boss only. The corporate executives can't get the basic information timely and accurately for too many levels. And the decision-making often based on their experience may lead to failure and the survival risk of the entire enterprise.

(2) Organizational structure is too rigid. In China, most small and medium manufacturing enterprises' organizational structure type is linear functions. There are many passing phenomenon for the less communication between departments and the slowly problem resolution. It is a serious impediment to the technological innovation of small and medium manufacturing enterprises. And the enterprises can not quickly adapt to new changes of circumstance, especially changes in corporate strategic planning.

3 Construction of Internal Control Frame in Small and Medium Manufacturing Enterprises Based on Comprehensive Risk Management

3.1 Construction of internal control system Based on comprehensive risk management

The inter control system based on comprehensive risk management is inter control system based on the whole staff, the whole process, the Omni-directional, which insists the principle of combining business development goals, operational efficiency, management efficiency. This article embarks from these three aspects, and has carried on the concrete analysis and demonstration, the basic framework of inter control system can be expressed as Figure 1.

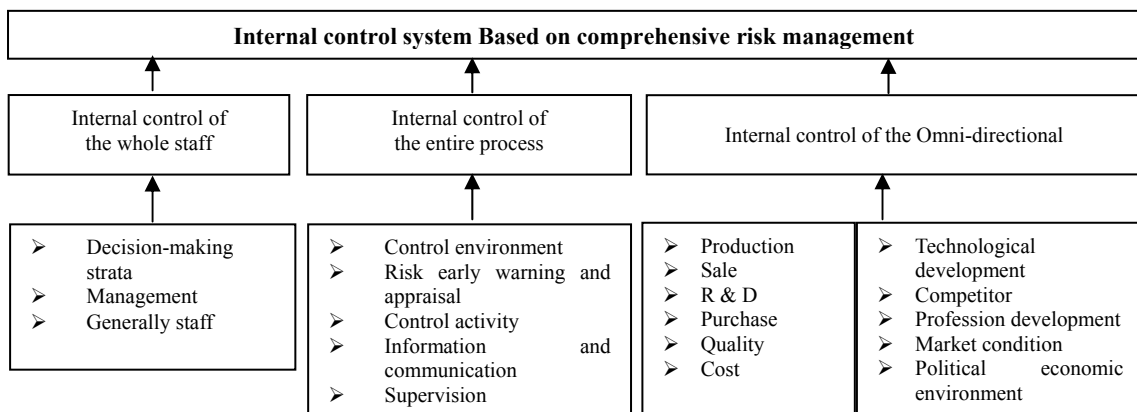


Figure 1 Internal Control System in Small and Medium Manufacturing Enterprises

Internal control of the whole staff is a full-in internal risk control that the leadership of the enterprise and the relevant functional departments to participate in. It was built with the principle of unified management, mutual cooperation and levels of responsibility, All departments and staff at all levels (decision-making, management, general staff) were a clear mandate, strict liability, joint responsibility. To achieve full internal control concepts, we need to build in-house risk management culture, risk control management will be fully embedded in corporate culture and all staff involved in the formation of a good culture.

(2) Internal control of the entire process

Internal control of the entire process is a closed-loop system of internal control that include risk warning and assessment, control activities, internal oversight and feedback, namely through before, during, and afterwards the "whole process" control, to achieve effective internal control. The whole process of internal control is consists by five elements of risk assessment, control environment, control activities, information and communication, internal oversight, they are interrelated and mutually reinforcing, Mechanism maps can be expressed as Figure 2.

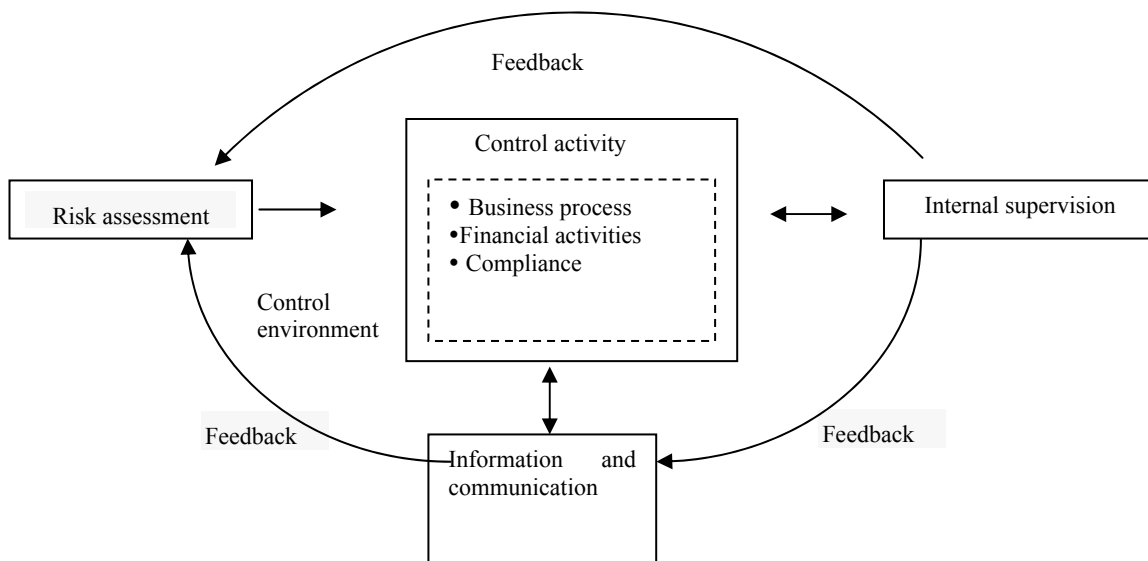


Figure2 Internal Control of the Entire Process in Small and Medium Manufacturing Enterprises Based on Comprehensive Risk Management

Control environment is an important foundation for the internal control of whole process. Covering corporate governance structure, management organizational structure and other aspects; risk warning and assessment is an important part of risk management, including process of the establishment of objectives, identify risks, assessment, control arrangements and so on. Control activities as an important means, which cover business like experience in business process, financial activities, and other business to achieve normative process and biodegradable targets; information and communication is an important condition for internal control, the key is to establish the communication channels and ensure the safety and reliability of information systems; Internal supervision is an important guarantee of internal control, through continuous monitoring and Independent assessment to achieve the supervision goals.

(3) Internal control of the Omni-directional

Establish a comprehensive internal control mechanism, the first is the establishment of control mechanism about production, marketing, research and development, purchasing, quality and cost within the enterprise, Secondly, understand the political and economic environment outside the enterprise, and other external environment like competitors, market conditions, technology development and so on, through the Combination of internal and external, create the "internal control effect", and ultimately achieve economic efficiency to improve product quality and reduce the cost.

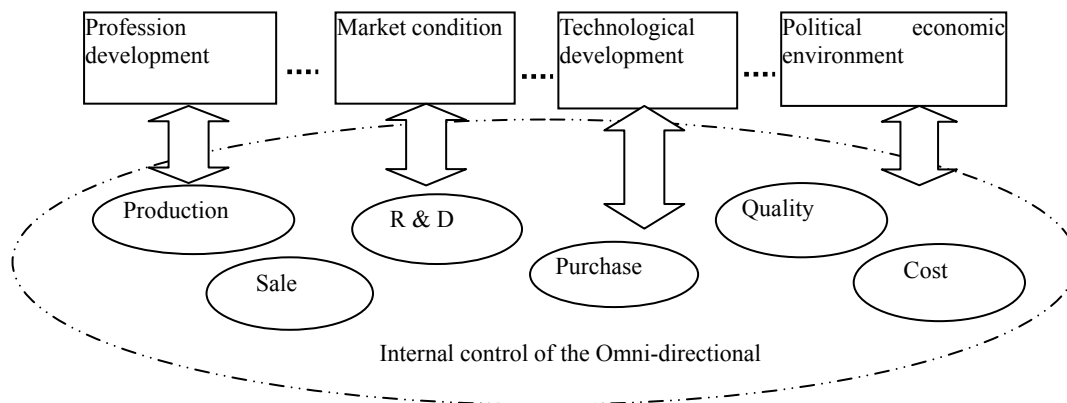


Figure3 Internal Control of the Omni-directional in Small and Medium Manufacturing Enterprises Based on Comprehensive Risk Management

3.2 Implementation Strategy

In order to promote the effective implementation of internal control system Based on comprehensive risk management, we propose the following suggestions:

(1) Enhance leaders' awareness of the comprehensive risk management

In order to strengthen business leaders' overall risk management awareness, the first is to improve management team's risk management concept, conduct study and training about cutting-edge knowledge of the internal control. Secondly, in the development of the relevant provisions of internal control, we must clear the business leaders' responsibility, to enable all staff work together to perform the requirements of internal control and promote the sound development of internal control.

(2) Foster good corporate culture, optimize the internal control environment

Healthy corporate culture can play a positive impact of the internal control. Small and medium sized manufacturing enterprises should establish a comprehensive risk management concept, and establish "the whole staff, the entire process, the Omni-directional" internal control culture, and strive to create risk awareness from the decision-making to the general staff which throughout the enterprise, to radically improve the internal control environment.

(3) Construction of rational organization

The organization structure should be clear authority and responsibilities of work of various departments and positions, while the incentive and restrictive mechanism aids, while establish Incentive and restraint mechanisms, rules of democratic management, transparent decision-making process, rigorous and efficient execution system and sound and effective monitoring system. To ensure the effective implementation of internal control mechanism, companies can set up a special internal authority department to implement the internal control responsibilities, thus to provide a guarantee for the smooth implementation of internal control on function.

(4) Establish a sound system

Establishment of a sound internal control system based on comprehensive risk management is the guarantee of small and medium manufacturing enterprises' internal control. Improve the enterprise system start from the following: First, improve enterprise-wide risk management system to help managers prevent corporate financial and other risks. Second, establish a sound system of internal check. Need to establish internal containment systems are: the internal audit system, financial approval authority, signature combination system, the analysis of costing and financial accounting system. Third, regulate the construction of business process. Small and medium sized manufacturing enterprises should sort out every aspects of the business and use unified process specification to draw flowchart. And make the key Process Management as Important indicator of performance evaluation.

4 Conclusion

This paper analyzes the small and medium manufacturing enterprises internal control and risk management status, Constructs small and medium manufacturing enterprises internal control frame based on comprehensive risk management, and puts forward proposals to promote its effective

implementation. The deficiency of this article is that it does not give some relevant case studies about corporate internal control management.

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