

Research on the Impact of Rectification of Internal Control Defects on Company Performance

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Abstract: In order to verify the relationship among internal control defect repair, company performance and internal control supervision, this paper makes a quantitative study on internal control defects of Lai Shen Tong Ling, and makes an empirical analysis through comparative study to verify whether there is any difference in the influence of internal control on company performance under the induced change stage and the mandatory change stage, and further illustrates the influence of internal control defects and repair on company performance.

Keywords: Internal control; Internal control defects; Repair of internal control defects; Company performance

1. Introduction

In recent years, with the continuous emergence of internal control defects in some listed companies, more and more scholars and investors focus on the information of internal control defects. Spreading negative news to the outside world due to internal control defects will bring a serious blow to listed companies, leading to a sharp decline in stock prices and performance. Therefore, when a company has internal control defects, the company must take measures to repair the defects, improve internal control, and make reasonable and correct rectification of the defects, which will improve the company's governance effect and financial performance. Taking the internal control defect of Lai Shen Tong Ling as an example, this paper analyzes the changes of the company's performance after this problem was disclosed and rectified, and takes this case as a reminder to other companies to promote the good development of the company.

2. Company profile and analysis of internal control defects

According to the official annual report and notice of Lai Shen Tongling, the 2014 annual report and the first quarter report of 2015 quarter were disclosed. Since 2014, the performance of Shenzhen Channel has declined, but the performance in the first quarter of this year has obviously rebounded, and the net profit attributable to shareholders of listed companies has increased by more than 400% year-on-year. In the analysis of the 2016 annual report, the company conducted a self-examination of funds, focusing on shareholders and related parties.

Nowadays, the army camp headed by Ma Jun, the actual controller, occupies more than half of the board seats. At the same time, the former chairman, officer Shen Dong, announced his resignation and Ma Jun took the position of chairman.

3. Internal control defects rectification and financial performance change analysis

3.1 Rectification of internal control defects after disclosure

Recognizing the harmfulness of defects, the company strengthened internal control management, revised and issued a number of internal control-related management systems, started the compilation of the Internal Control Manual, and rectified the existing defects.

3.1.1 The Company strengthened the management of asset impairment. Designate a special person to be responsible for the asset impairment assessment to ensure that the asset impairment assessment is timely and accurate. The company reviews the relevant system of converting construction in progress into fixed assets, entrusts the inspection of whether the construction in progress can be used to a special person in charge, strengthens the supervision of internal control, ensures the effective implementation of control, and converts the construction in progress that has reached the usable state for the first time into fixed assets.

3.1.2 Rectification of governance structure. The nonstandard corporate governance structure and the confusion of equity competition of major shareholders are the important reasons leading to the defects of internal control of the company. The new operation management team has improved the organizational structure according to the actual needs of market changes, refined the functions and responsibilities of various departments, and strengthened the sense of service.

3.2 Internal control defects rectification and financial performance change analysis

3.2.1 Rectification of internal supervision.

On the basis of improving internal control, the company has strengthened internal supervision, strengthened the supervision of the board of supervisors to the management and the audit department to the company, and strengthened the supervision of various departments, production links and production nodes. Internal control defects will affect the cost of debt capital, execution and on-the-job consumption, and then affect the financial performance of enterprises.

3.2.2 Impact of rectification of internal control defects on the cost of debt capital

Disclosure of internal control defects will damage the confidence of corporate creditors, lower the corporate debt rating, raise interest rates and increase corporate debt capital. If internal control can be carried out effectively, it will greatly increase the capital turnover capacity of enterprises, reduce costs, reduce the risk that creditors' principal and interest cannot be recovered, reduce the risk coefficient, and thus reduce the expected income.

3.2.3 Influence of rectification of internal control defects on executive power

The opportunistic behavior of managers can reduce the incidence of fraud and collusion among executives. The internal defect of corporate governance structure is the main reason for this phenomenon, which leads to the control of internal control by executive power.

3.3 DuPont analysis

Financial indicator analysis is to analyze these four indicators separately, while DuPont analysis is to integrate these four financial indicators and systematically analyze the impact of financial data. Dupont analysis focuses on the correlation between different financial ratios to reflect the financial performance of enterprises in a period of time. The analysis of each project contributes to a comprehensive and thorough understanding of the financial performance of the enterprise. As shown in Table 4-1.

$$\text{ROE} = \text{return on total assets} \times \text{Equity Multiplier} \times \text{return on total assets}$$

Table 4-1 Dupont Analysis

	In 2014	In 2015	the year of 2016
Return on net assets (%)	3.45	-37.63	2.06
Factor decomposition:			
Return on total assets (%)	0.85	-7.95	0.90
Net profit rate of sales (%)	1.75	-23.73	2.12
Total assets turnover rate (times)	0.49	0.33	0.42
Equity multiplier	3.35	4.47	4.54
return on total assets	3.71	-40.16	1.98

3.3.1 Return on net assets

The return on net assets reflects the net profit of the enterprise, which can directly reflect the profitability of investors.

3.3.2 Return on total assets

Return on total assets is a reflection of the enterprise's efforts during this period of time. The greater the net profit rate of sales and the turnover rate of total assets, the higher the return on total assets.

3.3.3 Net profit rate of sales

The net profit rate of sales reflects the relationship between the company's net profit and operating income.

3.3.4 Total assets turnover rate

The turnover rate of total assets is the effect of enterprises' grasp of the company's operating conditions.

3.4 Financial analysis

3.4.1 Profitability Analysis

See table 4-2.

Table 4-2 Profitability Analysis

index	In 2013	In 2014	In 2015	the year of 2016
Return on net assets (%)	2.59	3.45	-37.67	2.06
Earnings per share (yuan)	0.02	0.02	-0.18	0.01
Net interest rate of total assets (%)	0.81	0.85	-7.95	0.90
Net profit rate of sales (%)	0.89	1.75	-23.73	2.12

From the above analysis, it can be known that the negative impact brought by the disclosure of internal control defects in return on total assets decreased to a negative value in 2015, reflecting the weakening of the company's competitiveness in that year. In 2016, under the positive influence of rectification, return on total assets is still in a growth trend under the overall downward trend of the industry, and is gradually narrowing the gap with the industry average, which shows that rectification of internal control defects is helpful to promote the company's development and improve its competitiveness.

3.4.2 Analysis of operational capacity

See table 4-3.

Table 4-3 Analysis of Operating Capacity

index	In 2013	In 2014	In 2015	the year of 2016
Accounts receivable turnover rate (times)	7.54	3.68	3.27	4.89
Inventory turnover times (times)	2.44	1.34	1.14	1.38
Total assets turnover rate (times)	0.91	0.49	0.33	0.42

As can be seen from the above table, the accounts receivable turnover rate, inventory turnover rate and total assets turnover rate of Laishen Tongling showed a downward trend from 2013 to 2014. After the disclosure of internal control defects, the three indicators further dropped to a lower level in 2015, which showed that the operational capacity of production materials was weakened in that year. In 2016, after Lai Shen Tong Ling took measures to rectify internal control defects, all three indicators rose to a certain extent, among which accounts receivable and inventory turnover rate both rebounded to the level before defect disclosure, which indicated that internal control defects rectification had a positive impact on operational capacity.

Research conclusion

Through case study, it is found that:

1. There are three reasons for the internal control defects of Laishen Tongling Company. First, the equity competition of the company; Second, the company lacks the necessary risk assessment department, and when the company has risks, it cannot be found and solved in time; Third, there is no effective internal supervision mechanism. At present, the supervision of independent directors is not actually implemented, but only in form. In view of these reasons, Laishen Tongling Company should constantly improve the supervision mechanism and conduct risk assessment regularly in the future daily operation and development to avoid the occurrence of internal control defects of the company.

2. In the analysis of Lai Shen Tong Ling Company, we can know that internal control defects have a huge negative impact on the company's performance. Specifically, within one year after the internal control defects of Lai Shen Tong Ling were disclosed, its return on net assets, return on total assets, net profit growth rate and other indicators dropped sharply, while its overall profitability, operating ability, operating performance, operating performance, operating performance and so on all dropped significantly, and its growth ability and economic added value (EVA) dropped significantly. Therefore, in the future operation and development, companies should strengthen and improve internal control to reduce the risk of internal control defects.

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