

Research on the Effectiveness Evaluation of Internal Control in Internet Enterprises: Taking Rongtai Group as An Example

Mingming Wang^{1, *}, Fanrui Kong¹

¹ Economic and Management Department, Shanghai University of Politics and Law, China

Abstract

With the acceleration of the global process of the Internet economy, opportunities and risks in the external environment have significantly increased. The most basic prerequisite for enterprises to seize the wave of the times is to achieve their goals, and effective internal control is the most reasonable and effective guarantee for their own operations. This article takes Guangdong Rongtai Industrial Co., Ltd. as the research object, sets internal control evaluation indicators applicable to internet enterprises, evaluates the data of Rongtai Company, identifies problems in internal environment, risk management, information and communication, internal supervision, and proposes corresponding improvement measures.

Keywords

Internal control; Internal control evaluation; Internal environment; Internet enterprises.

1. Introduction

In An effective internal control system can significantly improve the efficiency of a company and ensure the accuracy of accounting information, reducing the occurrence of favoritism and fraud. Forming a complete and effective internal control system based on the company's own situation can help optimize internal control. This article intends to evaluate the effectiveness of internal control of Rongtai Industrial Co., Ltd. by selecting appropriate internal control evaluation models and indicators based on its own situation, identifying its existing problems, and proposing certain solutions and suggestions.

The internal control system is also constantly revised and improved based on the enterprise's own situation. If the internal control system is not based on the actual situation of the enterprise, its effectiveness is difficult to fully play. At the same time, if enterprises do not attach importance to the improvement and application of effective internal control systems, it is easy to cause damage to financial security, a decrease in business efficiency, and even embark on the path of illegal and criminal activities. Several major corporate violations in China that had a bad impact: the melamine incident of Sanlu Milk Powder Group, the Sudan stain Red incident and other tragedies were largely due to the failure of enterprises to form a complete, systematic and effective internal control system in combination with their own conditions. In order to avoid the recurrence of tragedy, it is imperative to improve the effectiveness of internal control in enterprises, and enterprises should also actively assume social responsibility and fulfill their obligations. This article intends to evaluate the effectiveness of internal control of Rongtai Industrial Co., Ltd. by understanding its specific

situation, selecting appropriate internal control evaluation models and indicators based on its own situation, identifying its existing problems, and proposing certain solutions and suggestions.

With the progress and development of the times, a large number of emerging enterprises have emerged in the global market. These enterprises are a mix of good and bad, including many excellent companies and some companies that engage in favoritism, fraud, and financial fraud. The recognition of a company by the market and investors is not only related to its profitability, but also closely related to factors such as its operating status, culture, credibility, and development prospects. A complete and effective internal control system can clarify the obligations and responsibilities of enterprises, which is of great significance for the development of enterprises and the stability of the market environment. This article will take the effectiveness evaluation of internal control of Rongtai Industrial Co., Ltd. as an example, identify the defects and problems in its internal control, analyze the results, and propose certain improvement suggestions and methods.

2. Literature review

In terms of evaluation models, there are currently two main types of evaluation models: the element view and the goal view. The element view is based on the characteristics of internal control elements, supported by a scientific Logical framework, and determines the evaluation criteria according to the requirements of each element; The goal view is to evaluate the relationship between internal control systems and unit goals based on the control objectives of the enterprise, using precise indicators.

2.1. Research on Evaluation Based on Internal Control Elements

James Roth and Donald Espersen conducted in-depth research on the COSO report, combining the purpose, process, and five major elements of internal control, and initiating a new model of internal control evaluation that is consistent with the five elements[1]. Joseph M. Onumah et al. found that the interaction between the five elements of internal control is particularly significant in improving the internal control system of enterprises[2]. When evaluating internal control, Shi Jun introduced the theory of control and risk, and set the content of the five elements as qualitative indicators to carry out evaluation work[3]. Zhang Fuling et al. shifted the evaluation of internal control from qualitative analysis to quantitative analysis[4]. Chen Hanwen et al. believe that constructing an index to evaluate the quality of internal control based on the "process view" of the five elements of internal control is more relevant and practical[5].

2.2. Research on Evaluation Based on Internal Control Objectives

Jokpii determines the degree of achievement of a company's goals by assessing whether its internal controls are effective[6]. Zhang Jide (2013) believes that internal control is an effective guarantee for enterprises to achieve corporate goals, and the degree of achievement of goals is particularly closely related to the effectiveness of internal control[7].

Based on the theory of internal control and from the perspective of the five elements, I have found that Rongtai Industrial Co., Ltd. has many problems in its business operation process.

Rongtai Industrial Co., Ltd. engaged in financial fraud and fraud, becoming the first case under

the new securities law to exceed the penalty of 600000 yuan for financial fraud. Zhang Aoping, the Managing Director of Capital, told the International Financial News that this reflects the determination of China's capital market to resolutely implement strict supervision of listed companies. Do a good job in supervising listed companies, ensure that there are no fraudulent practices, promptly eliminate enterprises that endanger the normal operation of the market, and ensure the healthy development of the capital market.

Rongtai Industrial Co., Ltd. inflated profits by 12.2469 million yuan and 43.0222 million yuan in the 2018 and 2019 annual reports. There are false records in the response to the inquiry letter and clarification announcement of the 2019 annual report of Rongtai Industrial Co., Ltd.

Rongtai Industrial Co., Ltd. has a worrying operating situation. Its profit performance has shrunk significantly in the past three years, even showing a negative growth of -34.3899 million yuan in the financial statements of 2021. And in 2021, there have been cases where major shareholders have significantly reduced their holdings of stocks.

Dahua Certified Public Accountants will be responsible for issuing Rongtai's Financial audit report in 2020. During the audit, the firm found that Rongtai subsidiary had major defects in project investment decision-making and capital Inventory control management, and there were major risks in customer credit evaluation and recovery of accounts receivable. Therefore, Dahua Certified Public Accountants issued a negative opinion on the audit report of Rongtai's internal control for the year 2020.

This article will start with the problems existing in Rongtai Industrial Co., Ltd. and analyze whether the internal control of Rongtai Industrial Co., Ltd. is complete, whether the evaluation is effective, and whether the mechanism is sound in daily operations. Based on relevant theoretical knowledge of internal control, evaluate the effectiveness of internal control, identify existing problems, and propose relevant rectification suggestions accordingly.

3. Theoretical Basis

Internal control theory refers to policies and procedures designed and implemented by governance, management, and other responsible parties to improve the reliability of financial statements, the effectiveness and effectiveness of operations, and compliance with laws and regulations[7]. The effectiveness of internal control refers to the reasonable assurance that the entity's internal control can achieve the entity's business objectives at the operational and planning levels[8].

Evaluating the effectiveness of internal control is a process. This article evaluates the effectiveness of internal control of Rongtai Group from both qualitative and quantitative perspectives, establishing a comprehensive evaluation index system for internal control effectiveness. Based on the current situation of Rongtai, a model is established to analyze the effectiveness of its internal control.

For the design of evaluation indicators, this article will use qualitative data, namely the five elements of internal control, as the indicator system x and assign values.

Five element indicator X and its secondary indicators under the five main indicators. The details are as follows:

Control environment (X_1): The organizational structure of the enterprise (X_{11}), corporate

culture (X12), and leadership (X13). Risk assessment (X2): Risk identification ability (X21), risk analysis ability (X22), and risk handling ability (X23). Control activities (X3): job division (X31), financial system (X32). Information and Communication (X4): Information System (X41), Information Processing (X42), Information Communication (X43), Anti Fraud Mechanism (X44). Monitoring (X5): Supervisory behavior (X51), Supervisory organization (X52). In the selection of quantitative indicators, this paper selects profitability indicators: Return on assets (Y11), Profit margin on sales (Y12), return on net assets (Y13); Solvency indicators: asset liability ratio (Y21), Current ratio (Y22); Operational capability indicators: accounts receivable turnover rate (Y31), total asset turnover rate (Y32), and revenue growth rate (Y33). The above qualitative and quantitative indicators have a very close connection and a certain degree of intersection, so the relationship between them can be expressed using a formula to obtain the evaluation score of internal control effectiveness[9].

The calculation method for evaluating the effectiveness of internal control is shown in Table 1.

Table 1: Calculation ideas for the effectiveness of internal control

Indicator	Abb.	Meaning	Formula
The effectiveness of internal control	Z	is calculated based on qualitative indicator X and quantitative indicator Y	$Z = \sqrt{\frac{X^2 + Y^2}{2}}$
Weighted result of qualitative indicators	X	Weighted results of the five elements of internal control. The weight w should be assigned based on the status of Rongtai Company.	$X = \sum_{1}^{5} X_n * w$
Weighted result of quantitative indicators	Y	Weighted results of operational indicators for Rongtai Industrial Co., Ltd.	$Y = \sum_{1}^{3} Y_n * w$

According to the scoring calculation process, the corresponding data of Rongtai Industrial Co., Ltd. can be substituted, and the evaluation results of the effectiveness of internal control of the enterprise can be obtained by comparing the table standards.

Table 2: Comparison Table of Internal Control Effectiveness Scores

Enterprise level	Score	Evaluation of the effectiveness of internal control
1st	Z > 80	Well controlled
2nd	65 < Z < 80	Normal
3rd	45 < Z < 65	Weak
4ed	Z < 45	Basic disorder

4. Case Analysis

Using fuzzy mathematics to establish a mathematical model and expert scoring method to evaluate the internal control of Rongtai, with a fuzzy value of $X=65.45$. Based on the actual situation of Rongtai Group and the audit report issued by Dahua Certified Public Accountants, the proportion of Rongtai's profitability, debt paying ability, and operating ability is set at 50%, 20%, and 30%.

Table 3: Evaluation Results of Internal Control Effectiveness of Rongtai Company

Ab b.	Formula	Calculation process	Results
X	$X = \sum_{n=1}^5 X_n * w$	Expert scoring method	$X=65.45$
Y	$Y = \sum_{n=1}^3 Y_n * w$	$Y = (-0.3077 - 1.1405 - 0.6318) * 0.5 * 100 + (0.6378 + 1.43)$ $* 0.2 * 100 + (1.88 + 0.27 - 0.2537)$ $* 0.3 * 100 = -104 + 41.367 + 56.889$	$Y = -5.744$
Z	$Z = \sqrt{\frac{X^2 + Y^2}{2}}$	$Z = \sqrt{\frac{65.45^2 + 5.744^2}{2}}$	$Z = 46.21$

Compared with the internal control effectiveness score comparison table (Table 2), Rongtai's internal control effectiveness is almost on the edge of abnormality. Rongtai's internal control system is relatively complete, so it is not a design defect of internal control but an operational defect. Rongtai's internal control has not been effectively operated, the independence of internal control personnel has not been guaranteed, and the company's neglect of long-term development strategies and pursuit of short-term benefits are important reasons for its internal control operational defects.

Dahua Certified Public Accountants, as the auditor of Rongtai in 2019, issued a negative opinion on the effectiveness of the internal audit of the financial statements of Rongtai Industrial Co., Ltd. The report states that an important subsidiary of Rongtai, Beijing Senhua Yiteng Communication Technology Co., Ltd., has hidden dangers in information system control. The existence of such problems makes it impossible for its internal control to ensure the integrity and objectivity of disclosed and undisclosed information. The significant deficiencies in the subsidiary have resulted in Rongtai's internal control losing this function as well. Subsequently, the board of directors of Rongtai agreed to the relevant opinions in the "Internal Control Audit Report" and acknowledged the problems in internal control. Therefore, qualitatively speaking, there are significant issues with Rongtai's internal environment, control activities, especially at the level of information and communication. Rongtai had a negative growth in operating revenue and extremely low return on assets in 2020. Based on the poor operating results in 2019, financial data became even more difficult to see. Obviously, Rongtai's ability to identify and respond to risks is not strong, and an accurate risk identification and evaluation system is urgently needed. Improve risk management

capabilities.

Dahua Certified Public Accountants, as the auditor of Rongtai in 2019, issued a negative opinion on the effectiveness of the internal audit of the financial statements of Rongtai Industrial Co., Ltd. The report states that an important subsidiary of Rongtai, Beijing Senhua Yiteng Communication Technology Co., Ltd., has hidden dangers in information system control. The existence of such problems makes it impossible for its internal control to ensure the integrity and objectivity of disclosed and undisclosed information. The significant deficiencies in the subsidiary have resulted in Rongtai's internal control losing this function as well. Subsequently, the board of directors of Rongtai agreed to the relevant opinions in the "Internal Control Audit Report" and acknowledged the problems in internal control. Therefore, qualitatively speaking, there are significant issues with Rongtai's internal environment, control activities, especially at the level of information and communication. Rongtai had a negative growth in operating revenue and extremely low return on assets in 2020. Based on the poor operating results in 2019, financial data became even more difficult to see. Obviously, Rongtai's ability to identify and respond to risks is not strong, and an accurate risk identification and evaluation system is urgently needed. Improve risk management capabilities.

5. Analyzing results

With the sustained and healthy development of the market economy, enterprises have generally reformed their internal control system, and the importance of internal control has greatly increased. Therefore, most listed companies have established a certain internal supervision system. However, there are often many shortcomings in the internal control capabilities of enterprises. Based on the evaluation results of Rongtai's internal control effectiveness and the evaluation index system table of internal control effectiveness, it is found that the problems in Rongtai's internal control are concentrated in five aspects: poor internal environment, insufficient control activities, hindered information and communication, low risk management ability, and lack of independence in internal supervision. Therefore, this article focuses on combining Rongtai's business data and disclosed information, and conducts targeted discussions on its existing problems from the perspective of the five elements of internal control.

5.1. Internal environment

On March 12, 2021, Rongtai was suspected of illegal information disclosure and received a penalty notice from the Guangdong Securities Regulatory Bureau. The Guangdong Securities Regulatory Bureau pointed out that Guangdong Rongtai is suspected of the following illegal facts: 1. Failure to disclose the 2019 annual report within the prescribed period; 2. Related relationships and daily operational Related party transaction are not disclosed in relevant reports as required. The actual relationship between the 2018 and 2019 annual reports was not disclosed, which was misleading due to the requirements and clarifications related to the 2019 annual reports. After investigation, it was found that there are serious deficiencies in Rongtai's internal control. In 2018, the inflated profit exceeded 12.24 million yuan. In 2019, the same method was used to inflate profits by over 43 million yuan.

The poor internal operating conditions of the company and the exposure of financial fraud

scandals have greatly affected the social image of Rongtai. Its corporate culture has seriously deviated from the actual situation. From the perspective of human resources, on June 4, 2020, Xu Luoxu, the secretary of the board of directors of Rongtai, resigned; On June 6th, independent director Li Xiaodong resigned; On July 8th, independent director Zheng Zibin resigned; On July 21st, director Lin Yuejin and power director Chen Shuijia resigned. In just two months, six of Guangdong Rongtai's 15 core management personnel have resigned, and only one of its four independent directors remains. The frequent resignations of senior executives have made the internal environment of Rongtai worse, and the core cohesion of the company has greatly declined. The company's development strategy for transformation also faces enormous challenges.

In terms of the organizational structure of the enterprise, although an audit committee has been established, it is led by and accountable to the board of directors. However, due to the low efficiency of the board of directors and insufficient attention paid to the audit committee, even if internal audits discover problems and report them to the board of directors, they cannot quickly implement solutions to the problems. On the contrary, driven by interests, board members often do not accept the suggestions proposed by the company's internal audits. Rongtai's financial data disclosure from 2019 to 2020 has been repeatedly delayed and even punished by the Guangdong Securities Regulatory Commission. In addition to the necessary information to be disclosed, Rongtai refuses to provide more information disclosure. Coupled with the financial fraud scandal, it is difficult to believe that its internal audit and internal control have played a role.

5.2. Control activities

There are many problems in the control activities of Rongtai Group, the most important of which is the extremely serious defects in the control of Rongtai's financial statements.

Dahua Certified Public Accountants conducted an audit of the effectiveness of internal control over Guangdong Rongtai Industrial Co., Ltd.'s 2019 financial report and issued a negative opinion on the audit report. The specific reason is that there were significant defects in the information system of Rongtai in 2019. The efficient operation of the internal control system can provide guarantees for the disclosure of corporate financial reports, and the significant deficiencies in Rongtai's internal control have already indicated its failure.

5.3. Risk Management

In terms of risk management, Rongtai Group also has significant problems, not only failing to timely detect the presence of subsidiaries in customers. There are significant risks in credit evaluation, and its listed stocks were also subject to other risk warnings in May 2021. The risk identification ability is worrying. In the analysis of the risks that have occurred, Rongtai quickly responded and stated that it will take certain measures to protect the legitimate rights and interests of investors. Although some initial results have been achieved, it still cannot solve the current risk problems.

As an important indicator of the effectiveness evaluation of internal control, risk management will greatly affect the realization of the effectiveness of internal control over the strategic objectives and asset objectives of the enterprise once problems occur. The weak risk management ability is an important reason for the low effectiveness of Rongtai's internal control.

5.4. Information and Communication

Rongtai has a relatively complete organizational structure, but there are problems with its ability to transmit and communicate information. The non-existent nature of the audit committee often results in information being delivered to senior management without response, resulting in a fragmentation of information transmission and communication, and the inability to play the role that information should play. This also leads to the gradual loss of independence of the audit committee, which undermines the organizational structure of the entire enterprise's internal control.

5.5. Monitoring

Rongtai's monitoring system has exposed significant problems under the disclosure of major risks, and the emergence of corporate fraud means that the monitoring system is malfunctioning. The opinions of the audit committee responsible to the board of directors are difficult to be adopted by board members, resulting in a serious profit seeking atmosphere within Rongtai. Long term monitoring failures also inevitably lead to the failure of internal controls.

Based on the evaluation results of Rongtai's internal control, the following targeted solutions are proposed to address the issue of near failure of Rongtai Industrial's internal control:

1. Optimize the organizational structure, pay special attention to the independence of the audit committee, and ensure the independence of the supervisory board; Constrain and supervise the rights of the management team to avoid the recurrence of embezzlement.
2. Develop a scientific and long-term development strategy. Only by truly focusing on long-term strategies can we effectively avoid financial fraud caused by current interests. We should highlight the development goals based on Rongtai's own situation, and the failure of the company's transformation should also trigger management thinking and clarify Rongtai's future path.
3. In terms of human resources, Rongtai's talent introduction mechanism is unreasonable. While human resources are scarce, the company's efficiency has decreased. Therefore, the talent introduction mechanism should be improved in a timely manner. In addition, inadequate constraints on talent, coupled with the functions of key high-level positions, can easily lead to fraudulent behavior.
4. Establish and improve a risk assessment system. Rongtai should determine its risk tolerance based on its own risk preference and anticipate the maximum level of risk it can accept in advance. Improve risk identification capabilities. A dedicated risk identification and analysis department can be established to design risk response plans, create dedicated information and communication channels to report identified risks to management, and minimize losses as much as possible.
5. Improve customer credit ratings, regularly inspect accounts receivable items, and reduce company losses.
6. Improve the control ability of monetary funds, ensure the independence of financial accounting and cashiers, and ensure the improvement of enterprise supervision and restraint mechanisms.

7. Establish an internal information transmission and communication mechanism to improve the coordination and timeliness of information transmission between various departments.

8. Rongtai should enhance the independence of internal control institutions and establish a dedicated internal control department that is independent of the internal control execution department. At the same time, external audit institutions are hired to regularly monitor their internal control functions, and internal and external integration is used to grasp the operation of internal control.

6. Conclusion

This article aims to optimize and deconstruct traditional Chinese culture into internal control related knowledge modules, integrating them into the teaching content of internal control, and enhancing students' professional literacy and knowledge connotation. The construction of internal control is often the focus of attention for Chinese scholars, but I believe that the reasonable construction of the internal control system is important, but it is more worthy of attention to achieve efficient operation of the internal control system. If it cannot be effectively operated, no matter how internal control is constructed, it will not play its ideal role.

Through evaluating the effectiveness of Rongtai's internal control, I have found that there are many problems in the internal environment, internal supervision, information and communication, risk management, and other aspects of Rongtai Group's internal control. The emergence and resolution of these problems can also provide some ideas to help enterprises with similar problems, ring the alarm for enterprises without such problems, and prevent such tragedies from happening again. In the evaluation process, this article uses methods such as qualitative analysis, quantitative analysis, case analysis, fuzzy mathematics, and expert scoring to evaluate the effectiveness of internal control of Rongtai Group, identify the problems faced by Rongtai, and propose corresponding solutions. During the research process, this article found that in the internal control system, the internal environment, information and communication, and risk identification and management are important links in determining the effectiveness of internal control, and are also the most prone to problems. Increasing attention to these three levels can greatly improve the effectiveness of the operation of the enterprise's internal control system.

In addition, internal control is not simply internal supervision. It is of great significance for the long-term development and social responsibility of enterprises, and internal control is largely rooted in the internal culture of the enterprise. Therefore, starting from the enterprise itself, increasing the importance of internal control can increase investment in the construction of the internal control system under certain conditions, which may not bring significant returns in the short term, But if we focus on a few years later, good internal control will definitely bring substantial returns to the enterprise. This is also the original intention of this article, hoping to attract the attention of scholars and enterprises, and to avoid such serious fraud from happening again.

References

- [1] Roth J, D Espersen. Risk Reflections [J]. InternAl Auditor, 2004 (1), 22-23
- [2] Joseph M. Onumah, Ransome Kuipo and Victoria A. Obeng. Effectiveness of Internal Control Systems of Listed Firms in Ghana [J]. Research in Accounting in Emerging Economies, 2012 (12): 31-49
- [3] Shi Jun. Research on the Construction of Internal Control Evaluation System for Chinese Enterprises from the Perspective of Corporate Governance [J]. Chinese Certified Public Accountant, 2012 (11): 51-57
- [4] Zhang Fuling. Construction of an Internal Control Evaluation Index System for Enterprises [J]. Operations and Management, 2013 (01): 102-105
- [5] Chen Hanwen, Huang Xuanhao. Internal Control Index of Chinese Listed Companies: Logic, Construction, and Verification [J]. Audit Research, 2019 (1): 55-63
- [6] Zhang Jide, Ji Dianbo, Sun Yongbo. Empirical Study on Factors Influencing the Effectiveness of Internal Control in Enterprises [J]. Management World, 2013 (8): 179-180
- [7] Jokipii A. Determinants and sequences of internal control in firms: a continuous genetics theory based analysis [J]. Journal of Management&Governance, 2010,14 (2): 115-144
- [8] Fang Hongxing, Chi Guohua. Internal Control [M]. Dongbei University of Finance and Economics Press, 2019:254
- [9] Chen Yang Research on effectiveness evaluation of internal control of FAW Car [D]. Lanzhou University of Finance and Economics, 2019, 13-20