

# Thoughts on Reconstruction of Financial Control System in Chinese Listed Companies in Perspective of Systems Theory

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## Abstract

In the circumstance of fast development of China's capital market, the increasing number of listed companies, and the more complicated corporate financial environment, companies should introduce the systems theory into corporate financial control and build more effective corporate financial control system in order to achieve survival and development. On the basis of systems theory, this paper analyzes the barriers for the implementation of financial control system in Chinese listed companies and the reasons, and tries to reconstruct and implement the corporate financial control system.

**Keywords:** Perspective of systems theory, Financial control system, Listed company

Today, with the development of capital market in China and the increasing uncertain elements for corporate financial management, the construction and implementation of financial control system in listed companies are the most powerful way for Chinese companies improving the governance and the management. Under the background of complex corporate finance, listed companies, as the independent, self-financing, self-restricting, and self-developing economic organizations, should build the effective corporate financial control system in perspective of systems theory, in order to achieve the survival and development.

## 1. Analysis of Systems Theory and Corporate Financial Control

### 1.1 System and Systems Theory

A system is a set of interacting or interdependent components forming an integrated whole. Systems theory takes research object as a system to recognize and process. Systems theory is the scientific exploration on the "integrity" of things. According to systems theory, corporate financial control activity is a large complicated system. A large system usually consists of many subsystems. These subsystems are interdependent and mutual restraint. Therefore, systems have integrity and connectivity. Since systems are the reasonable construction of subsystems by levels, systems have levels and orders. Meanwhile, systems are organic organizations and they have uniqueness as super systems, i.e. objectiveness and adaptation. Only by knowing these characteristics of systems, can we get the scientific and overall recognition to corporate financial work and promote the smooth development of corporate financial activities.

### 1.2 Corporate Financial Control

Corporate internal control is the organizing, planning, methods, and procedures implemented for internal restraints and adjustments in order to improve business efficiency and achieve full and sufficient acquirement and uses of various resources, realizing the expected management objectives. It is a necessary tool for effective implement of corporate strategy. Corporate financial management is to manage the flow of capitals. It involves all aspects of business operations. Therefore, corporate financial control is the center of corporate internal control. Corporate financial control is the process in which the company restrains and adjusts financial activities and makes them follow certain procedures and ways in order to ensure that the company and its internal organizations and staff fully carry out the financial budget. Corporate financial control, corporate financial forecasting, decision-making, budget, control, and analysis form the basic sections of financial management. Financial control has the determining significance for achieving the objectives of financial management. Corporate financial control is to use the scale of currency to control the production and business operations. It is the most continuous, systematic, and comprehensive control. Corporate financial control, with the functions of guaranteeing, promoting, supervising, and coordinating, holds a special position in the economic control

system of company. The role of financial control has the following three aspects: the first is to help achieve the corporate strategies and objectives, being the real-time monitoring method and also the assessment standards in work; the second is to protect the security and integrity of corporate assets in case of losses of assets; the third is to guarantee the authenticity and integrity of business information and financial and accounting materials.

Because financial management is in all aspects of business operations, it has significant impacts on production and operation. Financial control has a set of complete system composed by financial control environment, accounting systems, and control procedures. Financial control environment refers to a variety of factors for constructing or implementing financial control. The main factor is the attitude, recognition, and behavior of the management level and related staff, including corporate structure, managers' business ideas and management style, functions of managers and constraints to these functions, ways for establishing authorities and responsibilities, control measures for managers monitoring and examining operations, personnel strategies and the implementation, various external relationships influencing corporate operations, etc. Accounting system refers to the methods and procedures established by companies for the sake of accounting and supervising. An effective accounting system should: confirm and record all actual business operations, describe economic activities timely and sufficiently, sort the economic activities properly in financial accounting reports; measure the value of economic activities and record the appropriate monetary value in financial accounting reports; confirm the time of economic activity and record it in the appropriate accounting period; reflect economic activities and disclose accounting information in financial accounting reports. The control procedures are financial control methods and procedures established by managers, including the right of approval of economic activities; clarified division of responsibilities and avoid cheating; reflecting economic operations by the arrangement and use of vouchers and bills; manage and make best use of assets and materials; double checking the registered operations and the pricing.

### *1.3 Analysis of Relationships between Systems Theory and Corporate Financial Control*

Any social organization is a system composed of people, materials, and information. Any management is to manage the system. Without systems, there is no management. Systems theory provides a new perspective to recognize the nature and method of management. In addition, the view and method extensively penetrate into the human-oriented principle, the principle of responsibility, the principle of efficiency, and the principle of ethics. To some extent, systems studies play a dominating role in the organic system of management studies. According to system epistemology, the objective system, namely the system as an object, is the source for systematic and scientific understanding and the prototype of theory system. The scientific theory system is the reflection of system in minds. Therefore, we regard enterprise financial control as a system project, analyzing the characteristics of the system by the basic methods of systems theory, and exploring the mutual relationships and laws of changes between system elements, and the environment. Enterprise financial control system is a complicated operational system and also a complete knowledge system, covering the whole process of enterprise financial control activities. Enterprise financial control system is a subsystem of enterprise financial system. To deepen the research on enterprise financial control system will enrich the contents of enterprise financial management. To consider and regulate the extremely complicated enterprise financial control activities in perspective systems theory can make enterprise financial control activities produce great creativity, improving enterprise financial management level significantly.

## **2. The Barriers for the Implementation of Financial Control System in Chinese Enterprises and the Reasons**

### *2.1 The Traditional Financial System Cannot Achieve the Optimal Financial Control*

The defects of traditional financial system are mainly in three aspects: the absence of financial subjects and no sign of owners connecting with financial management; outdated financial ideas and without the function of enabling the enterprise and its financial managers to achieve self-organization and self-adaptation to the system; lack of basic methodology. These defects together make it impossible for the traditional enterprise financial system being the optimal control system because they prevent the financial management or control from reaching the optimal effect.

### *2.2 The Basic Financial Information of Some Enterprises Is Untrue*

Financial information reflects the business activities of enterprise in form of values. By financial information we can evaluate the business performance correctly and predict the prospects of enterprise. Modern enterprises are mostly large, with complex organizational institutions. The perfect information system is the basis for enterprise management. Financial information is one of the most effective information reflecting the operation of enterprise. Because the financial statements are untrue, plus the non-standardized enterprise accounting system and settings, and the failure of supervision, the financial reports cannot reflect the actual financial conditions, causing the untrue basic financial information.

### *2.3 The Financial Structures of Most Enterprises Are Unscientific*

Many enterprises have seriously unreasonable financial structures, especially the capital structures. The percentage of debts and the structure of assets and liabilities and the ownership equities are extremely unreasonable. Under the circumstance of shortage of capitals and in order to maintain the production and operation, the enterprise continues to borrow money, expanding the size of enterprise by increasing the debt ratio, which finally makes the burden of debts more serious, resulting in a vicious cycle.

### *2.4 Some Enterprises Pursue Something Large and Comprehensive, What Results in Scattered Resources*

The main purpose of production and business operation is to obtain economic benefits. Some enterprises do not have the right business ideas and blindly pursue large and comprehensive projects, engaged in many industries and fields, which results in the extreme scatter of resources and capitals. For production, financial investment, and real estate, there is no business connection among them. Besides, in the fields with low degree of connections, the management is more difficult due to the industries involved. It is not easy to find some talented managers familiarizing with many industries and comprehensive operations. If the business involves a variety of industries and fields, it will be very demanding work managing and controlling such a complex and diversified enterprise.

## **3. The Reconstruction of Enterprise Financial Control System**

### *3.1 The Basic Points*

(1) The objectives of financial control should be consistent with the highest objective of enterprise management. Financial control is a subsystem of enterprise management system. Therefore, the objectives of financial control should be consistent with the highest objective of enterprise management in order to promote the realization of highest objective of enterprise management by financial control.

(2) The objectives of financial control should be the unity of economic objectives and social ones. Economic objectives emphasize on the economic responsibilities of enterprise, pursuing maximum economic benefits, what are determined by the nature of economic management; social objectives emphasize on the social responsibilities of enterprise, pursuing maximum social benefits, what are determined by the social environment. Any enterprise lives in the complicated network of social relationships and all social relationships, to different degrees, restrict or affect the survival and development of enterprise. If an enterprise does not take social responsibilities or deal with various social relationships, the enterprise will not get the supports or rewards from the society, and even be punished by the society. An enterprise without social supports will stock in a helpless situation, and the survival and development will be more difficult. Accordingly, the objectives of financial control should focus on but should not limit to economic benefits, what should help the enterprise to fulfill the social responsibilities, pursuing the simultaneous optimal social benefits and economic benefits.

(3) The objectives of financial control should be the organic combination of strategic objectives and tactical objectives. Strategic objectives emphasizes on the long-term interests of enterprise, pursuing for the long-term stable development, while tactical objectives on the short-term interests, and for the growth of vested interests. The unity and opposite of long-term interests and short-term interests determines that in many cases the enterprise has to give up some immediate interests in order to obtain long-term interests, and must make tactical adjustments or even concessions for the sake of realizing the strategic objectives. Accordingly, if the objectives of financial control fail to embody the essence of enterprise's strategic development, it will inevitably lead to the short-term behaviors of financial control at the expense of long-term interests in exchange for immediate interests, which ultimately causes certain phenomena, e.g. complacency to current situations, satisfying with necessary interests, and no incentives for promotion, hindering the development of enterprise. Conversely, if the objectives of financial control lack of specific tactical requirements, the objectives will become castles in the air, which is not helpful for the enterprise examining the time and chance, developing and realizing financial tactics for different periods, obtaining periodical interests, and accumulating strengths for development. Therefore, the right way to establish objectives of financial control is to develop business tactics for different periods under the guidance of strategic development thoughts, to maximize short-term interests as much as possible on the basis of ensuring long-term interests, and to achieve the organic combination of strategic objectives and tactical objectives.

(4) The objectives of financial control must take interests of owners and that of other subjects into consideration at the same time. In market economy, creditors, employees, suppliers, consumers, and the Government have interests-related relationships with the enterprise, apart from the owners. Whatever the financial policies are, they must reasonably balance the interests of owners and that of other subjects, not discrimination or even ignorance. Only by this way, can the enterprise deal with a variety of economic relationships properly, maintain the dynamic balance of financial

distribution policies, win the trust and support of all interests-related subjects, ensure the smooth production and operation, and achieve the sustainable stable development.

### *3.2 The Specific Ideas of Setting up the Efficient Enterprise Financial Control System*

Enterprise financial control is a complex systematic project. It is necessary to design the enterprise financial control system reasonable according to the differences of objects. The financial control system is the key for improving the enterprise's management control efficiency. At present, in the comprehensive enterprise financial control system, we can set the financial information process control subsystem, the cash income and expense control subsystem, the cost control subsystem, the investment project control subsystem, and the asset-in-stock control subsystem.

Set up the financial information process subsystem. In order to ensure that financial information process is in accordance with enterprise's general financial objectives and requirements of financial and accounting regulations, it is necessary to achieve a real-time control over financial information process. The enterprise should set up some control points, e.g. examination, number, double check, and approval, strengthening the work of accounting audit, and guaranteeing the quality of information.

Set up the cash income and expense control subsystem. This subsystem is to deal with the cash income and expenses, the procurement of raw materials, the product sales, and the credits and debts, and control the applications for and returns of loans, the formation of financial successes, and the taxes. If they exceed the cash budget, they need the approvals of relevant departments. Finally, the cash income and expense reports reflect the real conditions of budget control of cash income and expense.

Set up the cost control subsystem. This subsystem is mainly to control a variety of consumptions caused by production according to the requirements of products' standard costs, quota costs, and expense budget. For all the spot where there is consumption of human resources, materials, or capitals, we must set up control points. Exceeding the quota standard is not allowed without permission.

Set up the investment project control subsystem. If the enterprise has investment projects, it is necessary to set up an investment project control subsystem to control the cash flow of projects, and strengthen the auditing of budget, achieving the sub-item control over direct and indirect expenses, according to the capital budget.

Set up the asset-in-stock control system. This subsystem is mainly to control the physical assets, e.g. cash, bank deposits, inventory, and fixed assets. The custody and use of assets should emphasize on safety, necessary legal documents, and valid receipts for transfer. Perform inventory verification periodically and write reports for both interests and losses. No activities are allowed without necessary procedures for approval.

## **4. Systems Thinking on the Implementation and Operation of Enterprise Financial Control System**

### *4.1 Use the Systems Thinking to Understand and Explore the Complex Problems of Enterprise Financial Control System*

Systems thinking means to study a system from the angle of systems theory. The way for systems thinking solving problems is to understand the reason for the complexity of enterprise financial control system, which is the relationship of each links in the system. To understand the system, we must take it as a whole to study. The purpose of designing the tools, techniques, and methods is to assist the integrity test. Understand and record the connections of parts, explain and explore the dynamic behaviors of these parts as a whole.

### *4.2 Design the Complete Organizational System for Enterprise Financial Control*

Systems theory is to study the phenomenon as a whole. Integrity is the important feature of the system. Enterprise financial control requires all departments to participate. To build financial control system, we must set up a complete organizational system for financial control. All departments are clear about their responsibilities and obligations, and work together to carry out financial control properly. The organizational system for financial control mainly includes the decision-making department, the functional department, and the responsible network. For the construction of organizational departments, we must establish the organizational forms and make it clear concerning the functions and reporting relationships, and division of responsibilities of each organizational unit. As the enterprise establish and improve the organizational arrangement, the principle of separation of incompatible responsibilities must be followed.

### *4.3 Apply the Dissipative Structure Theory to the Building of Enterprise Financial Control System*

According to the dissipative structure, the nonlinear interaction between various internal elements of the system is the internal mechanism for the formation of dissipative structure. In the enterprise financial control system, there is also nonlinear interaction between elements. The application of the dissipative structure theory should be on the basis of enterprise and its management, considering it as an imbalanced open system. This theory can help the enterprise and

financial managers to understand the law of decreasing management efficiency, thus unconsciously to enable the enterprise and its financial control become a self-organizing and adaptive system, so that the life cycle of enterprise is alive and prolonged. Take Game Theory as the basic methodology, not necessary to pursue short-term effects. Achieve the objectives by repeated game and build a financial control system or make the institutional arrangement to achieve “win-win” or “multiple-win” effects.

#### *4.4 Reasonably Construct and Properly Use the Internally-Linked Authorizing Approval Procedure System*

The authorizing approval control means the listed company controls the process of dealing with economic operations by authorizing approval. The authorizing approval control includes common authorization and special authorization. The common authorization regulates the powers, conditions, and people dealing with routine business. The daily operations can be handled properly by following regulations of powers and responsibilities. The special authorization is to authorize to deal with abnormal business, such as major financing activities, investment decisions, capital expenditures, stock issuance, etc. The special authorization can also be used for routine business exceeding common authorization limits and each business should have a series of internally-linked authorizing approval procedures.

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