Analysis of disclosure of Internal control information from Chinese listed companies

Xiangrong Hao†
Department of Accounting and Finance
Unitec Institute of Technology
Private Bag 92025,
Auckland 1140, New Zealand.
Email: xhao@unitec.ac.nz

Elizabeth A. Rainsbury
Department of Accounting and Finance
Unitec Institute of Technology
Private Bag 92025,
Auckland 1140, New Zealand.
Email: erainsbury@unitec.ac.nz

Corresponding Author: †Dr Xiangrong Hao, Department of Accounting and Finance, Unitec New Zealand, Private Bag 92025, Auckland, New Zealand. Telephone: +64 9 8154321 x 7016.
Email: xhao@unitec.ac.nz

Abstract

Purpose – The aim of this research is to examine internal control disclosures by Chinese cross-listed companies relating to guidelines issued by the government. All Chinese cross listed companies are required to disclose internal control evaluation reports in accordance with Internal Control Basic Standards and its supporting guidelines from 2011.

Design/methodology/approach – This research uses descriptive statistics method to analyses the internal control reports of Chinese cross listed companies.

Findings – This paper finds that, in general, Chinese cross listed companies have disclosed internal control information according to the regulations. However, the analysis also shows that there is some inconsistency in the application of the guidance, especially disclosures relating to internal control deficiencies, identification criteria and improvement procedures.

Originality/value – This study aims to contribute to internal control information disclosure research from Chinese cross listed companies perspective. In addition, this study offers suggestions on how the regulations can be improved which is another contribution of this study.

Keywords Internal control, Information disclosure, Regulation

Paper type Research paper

Introduction

The United States implemented internal control disclosure requirements under the Sarbanes-Oxley (SOX) Act in 2002 requiring listed companies to disclose internal control deficiencies and an internal self-assessment report assured by the external auditor. China's equivalent of the Sarbanes-Oxley of 2002 for internal controls was issued in 2008. The objectives of the Basic Standards for Enterprise Internal Control (hereinafter referred to as the Basic Standards) is to strengthen and standardize internal controls of businesses to promote sustainable development, improve risk management and avoid disruption to markets resulting from financial scandals. The Basic Standards were supported by The Enterprise Internal Control Supporting Guidelines (hereinafter referred to as Supporting Guidelines) introduced in 2010 and were first to be applied to cross-listed companies on the Shanghai and Shenzhen Stock Exchanges from January 1st 2011.

This study examines the application of the Chinese internal control regulations by cross-listed companies – the first group of companies impacted by the new regulations. The study assesses the implementation of the guidelines and makes recommendations for their improvement.

The remainder of the study is structured as follows: Section two provides backgrounds the regulatory requirements for the internal control disclosures and provides a brief review of the internal control disclosure literature. Sections three outlines the research method, sample selection. Section 4 analyses the application of the internal control regulations by cross-listed companies for 2012. Section 5 discusses the finding and section 6 concludes the study.

Background and literature review

Background to internal control guidelines

A robust internal control system is a powerful management tool and a means for a business to achieve performance and profitability targets, and to prevent loss of resources. Such systems help to ensure reliable financial reporting and compliance with laws and regulations. Cases of financial fraud are often linked to a firm's weak system of internal control.

Prior to the Basic Standards being issued, the Shanghai Stock Exchange issued internal control guidelines for listed companies in 2006. In the following year the guidelines were published by the Shenzhen Stock Exchange. The guidelines require companies listed on the exchanges to establish internal control systems to ensure the efficiency of operations, the safeguarding of assets, compliance with laws and regulations and ensuring the integrity of information disclosure. The implementation of the guidelines meant that internal control information was being disclosed to investors of Chinese listed public companies for the first time.

However, the disclosure of internal control information by Chinese listed companies was largely a formality with no substantive content. (Li et al., 2003). Even after the Shanghai Stock Exchange guidelines were mandatory, the vast majority of Shanghai-listed companies did not disclose internal control information in accordance with the regulation (Fang and Sun, 2007).

In 2008 China's Ministry of Finance, Securities Regulatory Commission, National Audit Office, Banking Regulatory Committee and Insurance Regulatory Committee issued the Basic Standards. The Basic Standard provides an internal control framework comprising the control environment, risk evaluation, control activities, information and communication and control monitoring. It also set out the regulatory requirement that for Chinese listed companies to evaluate and assess the effectiveness of their internal controls and for auditor to give an opinion on the effectiveness of the firm's internal controls. Companies have to publish a self-evaluation report on the effectiveness of the firm's internal control, systems and an audit firm is required to provide an opinion on the effectiveness of the systems. The Basic Standard was supported the Supporting Guidelines issued in 2010.

The Supporting Guidelines comprise three sets of implementation guidance:

Application Guidelines. This regulation identifies eighteen business areas to develop internal control systems. The areas range from organizational structure to procurement activities to financial reporting. The list is provided in Appendix.

Evaluation Guidelines. A framework for performing assessment of internal controls is outlined. This regulation comprises guidance for internal control evaluation contents, procedures, deficiencies identification criteria and internal control report. It requires the following information should be disclosed in the internal control report, as a minimum:

a) Authenticity statement of internal control report by the board of directors;
b) Overview of the internal control evaluation;
c) The basis of internal control evaluation;
d) The scope of internal control evaluation;
e) Procedures and methods of internal control evaluation;
f) Internal control deficiency and recognition;
g) Rectification of internal control deficiency and correction actions which are going to be used for significant deficiency.
h) Conclusion of effectiveness of the internal control

Audit Guidelines. These are guidelines for auditing of internal control and they provide accounting firms direction on their responsibilities and standards of the assurance engagement.

Research on disclosures of internal control information

The literature on internal control reporting is wide ranging with a number of studies generated as a result of Sarbanes-Oxley of 2002 (see for example Schneider et al., 2009). Using Schneider, Gramling, Hermanson, and Ye's (2009) framework for internal control research we focus on two main strands of the research literature – the characteristics of companies disclosing internal control weaknesses and the effects of internal control weaknesses.

Characteristics of firms with internal control weaknesses. Bryan and Lilien (2005) examined public filings of firms with internal control weaknesses and found that they were generally smaller, riskier and not high performers in their industry. Doyle et al. (2007) examined 779 firms with material internal control weaknesses from 2002-2005 to identify if the weaknesses were entity-wide or account- specific. Consistent with Bryan and Lilien (2005) firms with entity-wide internal control weaknesses are generally smaller, younger and less profitable. Firms with account-specific weaknesses are generally profitable but are more complex, diversified, growing rapidly or restructuring.

In a period prior to the mandatory SOX requirements Ashbaugh-Skaife et al. (2008) considered the factors that may be associated with the disclosure of internal control weaknesses in a voluntary environment. Those firms' disclosing internal control weaknesses were more likely to have complex operations or have major organisational changes such as restructures, mergers and acquisitions. Disclosure of internal control weakness was also positively associated with firms that held more inventory and were growing fast. Firms with losses and more financial distress were also more likely to have internal control weaknesses.

In a further extension of the internal control weakness research, Rice and Weber (2012) identify firms with financial restatements relating to weaknesses in internal controls. They then trace back to the period when the reporting errors were made to determine if the firms disclosed internal control weaknesses as required by section 404. Only 32.4% of firms reported the existence of weaknesses and that this proportion has declined over time. They argue that these results suggest that the section 404 requirements are not effective and examine manager and auditor incentives that may affect the level of disclosure.

Some researchers in China believe that the quality of internal control information disclosure is positively correlated with the scale of the board, the proportion of independent directors, the state-owned dominant shareholders and negatively correlated with the board chairman taking on the dual position of CEO (He et al., 2011). The actual controller plays a fundamental factor impacting on internal control information disclosure. If the actual controller is different (including classes, nature and identity) information disclosure of internal control will be different (Han, 2012). Especially in China's private owned listed companies, due to the absence of board characteristics, the motivation in internal control information disclosure is lacking. Often for obvious reasons, only selected information has been disclosed (Wang and Xu, 2011).

Effects of internal control weaknesses. Research shows that the disclosure of internal control information is related to corporate value. There is a positive correlation between good internal control information and share price reactions (Krishnan Sami and Zhour, 2008) while markets respond negatively to internal control weaknesses (Ashbaugh-Skaife et al., 2008).

Similar market reactions have been reported using Chinese data. Yang et al. (2012) examined the market reactions to the disclosure of internal control using Chinese listed companies in Shanghai Stock Exchange from 2006 to 2009 as research samples and they found that there is a stronger relationship between mandatory internal control information disclosure and corporate value than with voluntary disclosure. The effective internal control information disclosure caused the stock price to rise, however, internal control deficiencies caused the stock prices decline. Feng and Cai (2008) also discovered similar market effects to internal control information based on the data from Chinese listed companies in Shanghai Stock Exchange from 2003 to 2006.Huang and Song (2012) estimated that firms with good internal control information disclosure can increase corporate value by at least 1% compared to firms not disclosing internal control information based on an empirical study on 2157 sample companies listed in Shanghai stock exchange.

Sample selection and research method

The internal control regulations were first introduced for cross listed companies on January 1, 2011. This study examines the internal control disclosures of 67 cross listed companies on the Shanghai and Shenzhen stock exchanges. All but one of these companies were cross listed on the Hong Kong stock exchange. The other company was cross listed on the Singapore stock exchange. Nine of the companies were also listed on the New York Stock Exchange in addition to listing on Shanghai and Hong Kong stock exchanges.

The companies were analysed by industry are listed in Table I. The companies cover nine of the 13 industries industry categories specified by the Chinese securities regulation. They include mining manufacturing, electrical power, construction, transportation, information technology, finance, insurance, real estate, and social services. The majority of the Chinese cross listed companies are involved in the manufacturing (40.3%), transportation (18%), finance and insurance (16.4%) and mining (10.4%). Cross listed companies in the manufacturing industry are dominated by companies producing mechanical equipment and metals and non-metals.

Insert Table I

The total revenue generated by the 67 companies is huge. It was RMB ￥12,133 billion in 2011, representing about a quarter of China's GDP in the same year. Each company has total revenue of more than ￥0.1 billion in 2011. Table II provides the distribution of revenue.

Insert Table II

The 2011 annual reports for 67 companies were downloaded from the CNINF website (http://www.cninfo.com.cn/). We use descriptive statistics researching method to assess if the contents of the internal control reports of Chinese listed companies met the requirements of internal control evaluation Guidelines. Each section was read to determine if the guidelines had been met – and recorded as “Yes” complying with the regulation and “No” if not.

For the “Deficiencies and Rectification section a distinction was made regarding the quality of the disclosure. “Detail” referring to a company using qualitative and quantitative indicators of internal control deficiencies and discussion of improvements and "Simple” referring to a general description or explanation.

Findings

Overall Compliance

All the 67 Chinese cross listed companies disclosed their annual financial reports, internal control evaluation reports and internal control audit reports by 30 April 2012. All but one of the 67 companies received unqualified opinions on their internal control audit reports. Xinhua Pharmaceutical got an adverse opinion resulting from a significant deficiency in the company’s internal control.

Figure 1 shows that 12 accounting firms audited the internal control reports of the 67 cross listed companies. The “Big Four” accounting firms dominated, auditing 46 (68.7%) of the companies with PWC auditing 16 of these. The remaining 21 companies, accounting for 31.3% of the total, were audited by China domestic accounting firms.

Insert Figure 1

The audit of the financial statements and internal control system were carried out by the same accounting firms, except for three companies: Wechai Power, Beiren Printing Machinery and China Railway Construction.

Compliance with Evaluation Guidelines

As stated in background to internal control guidelines, the Evaluation Guidelines list eight elements to be included in the Internal Control Evaluation Report to be prepared by each company. Table III summarises the level of compliance of these eight elements.

Insert Table III

The Evaluation Guidelines require the companies to confirm that the Board of Directors is responsible for the establishing and maintaining an effective system of internal control and that they are responsible for the truthfulness for the information disclosed. All 67 companies provided the statements with 35 companies using a standard “Board Statement”.

All the companies provided an overview of the internal control environment and the division responsible for internal control matters in the company. In many cases companies had an internal control committee reporting to the board of directors.

Fifty two (78% of total) companies provided a section on “internal control evaluation scope” which identifies the business areas listed in the Application Guidelines that are included in the internal control system. Eight companies did not set up a separate section but disclosed the required information in sections such as "overall information", “evaluation contents " "specific implementation" and "appendix". Seven companies did not comply.

According to the Supporting Guidelines, the internal control evaluation process generally includes developing an evaluation scheme, forming an evaluation working group, implementing on-site testing to identify control deficiencies, summarizing and evaluating the results and preparing the evaluation reports. Evaluation methods should be integrated and can include the use of individual interviews, questionnaire, symposia, walkthroughs, field inspections, sampling, and comparative analysis.

Fifty-nine of the sixty-seven companies disclosed their internal control evaluation procedures and methods. The methods most commonly used were interviews and sampling. A few companies such as Tianjin Zhong Xin Pharmaceutical Group used system review methods which are not included in the Supporting Guidelines.

Table III shows that 24 companies provided a detailed description of the internal control deficiencies while another 25 companies provided a very brief description of the deficiencies. Eighteen companies disclosed that they had no deficiencies. Very few companies proposed corrective measures and many of them used generic statements such as “adjusting staff positions”, “amending systems” and “business process reengineering”. There was little evidence of a detailed corrective plan to fix an internal control deficiency.

Insert Table IV

Table IV shows a summary of the nature of the internal control weaknesses. Only one company Xinhua Pharmaceutical had a significant deficiency. An extract form the Internal Control Evaluation Report follows:

Extract 1: Significant Deficiency - Xinhua Pharmaceutical

According to the standards above, combined with results of daily supervision and project supervision, during our evaluation we found a significant deficiency in the report period that the lines of credit to customers has become too large, causing significant losses in a subsidiary, Shandong Xinhua Pharmaceutical Medical Trading Ltd (hereinafter referred to as the MTL).

The internal control system of the MTL lacks a clear provision of multilateral credits. The MTL’s Lu Zhong Branch, industrial department and Commercial Department gave credits to the same customers at the same time, which led to a great rise in the credit amount.

Although there are regulations in the internal control system of the MTL, saying that the lines of credit cannot be greater than the customer's registered capital, some of the customers have been given credits which were beyond its registered capital.

The significant deficiency caused the company to have accounts receivable to Shandong Xin Kang Qi Pharmaceutical Ltd (SDXKQ) of ￥60,730,000, at the same time, because of the financial difficulties SDXKQ is experiencing, which may make the company suffer even more serious losses.

Two companies reported the existence of important deficiencies. Jiangxi Copper reports the existence of seven major deficiencies but fails to disclose the details of the defects as shown in Extract 2.

Extract 2: Important Deficiency – Jiangxi Copper

According to the above criteria, combined with the daily supervision and special supervision, we found that there are 1,017 deficiencies during the reporting period, including 7 important deficiencies, no significant deficiency.

Similarly, in Extract 3, China Shipping Container Lines report one important deficiency without any information on the nature of the defect.

Extract 3: Important Deficiency – China Shipping Container Lines

According to the above criteria, there are six internal control deficiencies during the report period. Among them, one is important deficiency, the other five are general deficiencies.

Forty six companies described general deficiencies very loosely such as defects in systems, processes, procedures and systems. The balance of 18 companies had no internal control weaknesses simply stating that “according to the company standard, combined with daily supervision and special supervision, we found no significant defects during the reporting period”. This study finds that the quality of disclosure of the internal control deficiencies was superficial with very brief disclosures and little explanation of the nature of the internal control deficiencies.

According to Supporting Guidelines, the effectiveness of internal control has to be clearly described in the internal control evaluation report. As long as there are no significant deficiencies, internal control effectiveness conclusions should have statements such as “Board of Directors has evaluated the internal control within financial report in accordance with requirement from × × ×” and “During the reporting period, internal control systems have been established and effectively implemented for all the aspects within the evaluation scope, there are no significant deficiencies”. Except for Xinhua Pharmaceutical which concluded its internal control was ineffective due to significant deficiencies, the remaining 66 companies have all made positive internal control effectiveness conclusions. However, only 57 sample companies have sections dedicated for “internal control effectiveness conclusions”, there are still 10 companies that have not listed the relevant information separately.

Discussion of findings

Compliance with the internal control regulations for Chinese cross listed companies in 2011 is generally positive. The study shows that 59 companies met or basically met the Internal Control Basic Standard and its Supporting Guidelines, while eight did not cover all the requirements in particular the deficiencies and rectification of internal controls problems.

While compliance was high here are issues around the quality of information disclosed. The Supporting Guidelines specify the disclosure areas, however, there is no set format. Companies structured their reports in different ways making them difficult to follow and to identify the relevant information. There appears to be a need for further regulation to standardise the format of the internal control reports. Furthermore, as this study finds that internal control deficiencies information disclosure is the area that has most problems, we suggest internal control deficiency identification criteria, types, content and nature in the Internal Control Evaluation Guidance all need to be refined.

Conclusion

The Chinese government introduced regulations requiring listed companies to disclose the assessment and auditors opinion on the effectiveness of their internal control. This study examines the level of compliance with the regulations for cross listed companies, the first group of companies required to implement the regulations.

Our analysis shows that while the Chinese companies have complied with the legal form proving the necessary disclosures but the quality of the disclosures are poor especially in relation to discussing the nature of the internal control deficiencies and plans and processes in pace to eliminate them. Further work is required to improve the substance of the disclosures.

References

Ashbaugh-Skaife, H., Collins, D. and Kinney, W. (2007), “The discovery and reporting of internal control deficiencies prior to SOX-mandated audits”, Journal of Accounting and Economics, Vol.44, pp. 166-192.

Ashbaugh-Skaife, H., Collins, D. Kinney, W. and LaFond, R. (2008), “The effect of SOX internal control deficiencies and their remediation on accrual quality”, The Accounting Review, Vol.83 No.1, pp. 217–250.

Ashbaugh-Skaife, H., Collins, D. Kinney, W. and LaFond, R. (2009), “The effect of SOX internal control deficiencies on firm risk and cost of equity”, Journal of Accounting Research, Vol.47 No.1, pp. 1-43.

Bai, H. and Gao, L. (2011), “Internal control of financial report: A paradox”, Accounting Research, No.3, pp.68-75.

Boritz, J. and Zhang, P. (2006), “How does disclosure of internal control quality affect management's choice of that quality”, available at http://papers.ssrn.com/sol3/papers.cfm?ab stract_id=874890.

Bryan, S. and Lilien, S. (2005), “Characteristics of firms with material weaknesses in internal control: An Assessment of Section 404 of Sarbanes Oxley”, available at: http://ssrn.com/abstract=682363 or http://dx.doi.org/10.2139/ssrn.682363.

Carney, W. (2005), “The costs of being public after Sarbanes-Oxley: The irony of ‘going private’”, available at:

http://papers.ssrn.com/sol3/papers.cfm?abstract_id=672761.
Chen, L. and Zhou, S. (2010), “Empirical research of internal control efficiencies based on listed companies-a perspective from financial auditors”, Modern Economics, No.10, pp.120-128.
Doyle, J., Ge, W. and McVay, S. (2007), “Determinants of weaknesses in internal control over financial reporting”, Journal of Accounting and Economics, Vol.44, pp.193-223.
Fang, H. and Jin, Y. (2011), “Can internal quality control suppress earnings management? –A research based on voluntary internal control report”, Accounting Research, No.8, pp.53-60.
Fang, H. and Sun, Y. (2007), “Mandatory internal control disclosure under the control of the internal rules - an empirical research based on the annual report for the listed company in Shanghai Stock Exchange”, Financial and Economic Issues Studies, No.12, pp.67-73.
Feng, J. and Cai, C. (2008), “Internal control information disclosure of listed companies”, Financial Sciences, No.5, pp.80-87.
Gopal,K. and Gnankumar, V. (2005), “Reporting internal control deficiencies in the post Sarbanes-Oxley Era: The role of auditors and corporate governance”, available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=646925.
Han, X. (2012), “Influence of the actual control party on internal control information Disclosure -- empirical research based on listed companies on main board Shenzhen A-Share during 2009-2010”, Journal of Shanxi University of Finance and Economics, No.12, pp.83-91.
He, J., Zhang, X. and Zhou, S. (2011), “Internal control information quality and influencing factors for listed companies -- research based on empirical data from governance perspective”, Journal of Shanxi University of Finance and Economics, No.3, pp.98-106.
Hermanson, H. M. (2000), “An analysis of the demand for reporting on internal control”, Accounting Horizons, Vol.14 No.3, pp.325-341.
Huang, H. and Song, X. (2012), “Internal control reporting, accounting information quality and business value -- an empirical research on A market in Shanghai Stock Exchange”, Economics Management, No.1, pp.122-128.
Ku, E. (2012), China’s internal control and audit regulatory framework, available at:http://www.china-briefing.com/news/2012/03/09/chinas-internal-control-and-audit-regulatory-framework.html#sthash.GJQta1tG.dpuf.
Leuz, C., Karl, L. and Francis, W. (2009). Do foreigners invest less in poorly governed firms? Review of Financial Studies, Vol.22 No.8, pp.3245-3285.
Li, M., He, H. and Ma, X. (2003), “Status analysis on internal control information disclosure from listed companies in China”, Auditing Research, No.1, pp.38-43.
Lin, B., and Rao, J. (2009), “Why do companies disclose internal control information voluntarily? -- Empirical research based on signal theory”, Accounting Research, No.2, pp.45-52.
Lobo, G. and Zhou, J. (2006), “Did conservatism in financial reporting increase after the Sarbanes-Oxley Act? Initial evidence”, Accounting Horizons, Vol.20 No.1, pp.57-74.
McMullen, D. A., Roghuandan, D. and Rama, D. V. (1996), “Internal control reports and financial reporting problems”, Accounting Horizons, Vol.10 No.4, pp. 67-75.
Ministry of Finance of the People’s Republic of China. (2008), “Enterprise Internal Control Basic Standard”, available at: http://www.mof.gov.cn/zhengwuxinxi/caizhengwengao/ caizheng-buwengao2008/caizhengbuwengao20087/200810/t20081030_86252.html.
Ministry of Finance of the People’s Republic of China. (2010), “Enterprise Internal Control Supporting Guidance”, available at http://kjs.mof.gov.cn/zhengwuxinxi/zhengcefabu/ 201005/t20100505_290459.html.
Ogneva, M., Subramanyam, K. R. and Raghunandan, K. (2007), “Internal control weaknesses and cost of equity: Evidence from SOX Section 404 disclosures”, The Accounting Review, Vol.82 No.5, pp.1255-1297.
Qiu, D., Chen, L. and Meng, W. (2010), “Internal control information disclosure and IPO underpricing--empirical study Shenzhen SME board”, Accounting Research, No.10, pp.34-39.
Schneider, A., Gramling, A. Hermanson, D. R. and Ye, S. (2009), “A review of academic

literature on internal control reporting under SOX", *Journal of Accounting Literature,* Vol.28, pp.1-46.
Shanghai Stock Exchange. (2006), "Circular of Shanghai Stock Exchange concerning issuing the guidelines for Shanghai Stock Exchange for the internal control of listed Companies", Available at: http://www.adcommission.gov.au/cases/documents/068-Submision-ForeignGove-rnment-GovernmentofChina-Attachment57-ShanghaiStockExchangeGuideli.pdf
Shen, H. (2007), "Corporate characters and voluntary disclosure of social responsibility Information -- evidence from listed companies in China", Accounting Research, No.3, pp.9-16.
Shenzhen Stock Exchange. (2006), "SSE promulgates the internal control guidelines of listed companies", available at: http://www.szse.cn/main/en/AboutSZSE/SZSENews/SZSENews/9644.shtml
Song, S. and Zhang, Y. (2008), "Impact factors of internal control information disclosure from the corporate governance perspective -- Empirical evidence from Chinese A-share market", *Academic Edition of Accounting Communications,* No.10, pp.88-91.
The Compliance Guidelines for Enterprise Internal Controls, available at: http://economists-pick-research.hktdc.com/business-news/article/Economic-Forum/The-Compliance-Guidelines-for-Enterprise-Internal-Controls/ef/en/1/1X000000/1X070UVN.htm
United States of America. Sarbanes Oxley Act of 2002, available at: http://www.sox-online.com/act_section_302.html.
Wang, K. (2004), "Empirical analysis on the changes of operating performance of listed companies issuing A and B shares", Statistics and Management, No.4, pp.24-28.
Wang, L., and Xu, Y. (2011), " Status research on internal control information disclosure from listed companies", *Journal of Yunnan University of Finance and Economics (Social Science Edition)* No.3, pp.103-110.
Willis, D. M. and Lightle, S. S. (2000), "Management reports on internal control", *Journal of Accountancy*, Vol.190 No.4, pp.57-64.
Yang, Q., Yu, L. and Song, L. (2012), "Internal control information disclosure and market reaction research -- experience Data from listed company in Shanghai Stock Exchange", *Nankai Business Review,* No.1, pp.21-30.
Yang, Y., Wang, H. and Cao, Q. (2010), "Correlation between quality of internal quality control information and agency costs-empirical research data based on the listed companies on the Shanghai Stock Exchange in 2007", *Accounting Research,* No.1, pp.82-88.
Yang, Y. and Chen, L. (2009), "Study on self-evaluation report of internal control of listed companies in Shanghai Stock Exchange in 2007-data analysis and policy recommendations", *Accounting Research,* No.6, pp.58-64.

Appendix. China SOX – Aspects of Internal Control According to Internal Control Application Guidance

Features	Description
Organizational Structure	Ensure that decision-making, execution and supervision are separate and form adequate checks and balance Conduct an overall evaluation of the efficiency and effectiveness of the design and operation of its organization on a regular basis
Development Strategy	Set up a strategy committee to be in charge of the management of development strategies and formulation of a development strategy proposal, which will be implemented after adoption upon deliberation by the board of directors and approval at the shareholders' meeting
Human Resources	Formulate annual plans on human resource needs and evaluate its execution on a regular basis

Social Responsibilities	Establish stringent work safety management systems, rigorous product quality control and inspection systems Diligently perform energy conservation and emission reduction responsibilities Establish a scientific employee remuneration system and incentive mechanism Ensure the entitlement of staff members to rest and leave days
Corporate Culture	Actively cultivate a corporate culture and a corporate culture assessment system which focuses on whether the directors, supervisors, managers and other senior management personnel have performed their duties in corporate cultural building and whether all employees identify with the enterprise's core values
Fund-related Activities	Based on its fund-raising goals and planning, draft fund-raising programs in light of the annual overall budget, specify the purposes, Amount and structure of the funds to be raised and the fund-raising methods, and make sufficient estimates of the fund raising costs and potential risks
Procurement Activities	Put procurement operations under centralized management, and avoid procurement from too many suppliers or decentralized procurement
Asset Management	Adopt advanced inventory management technologies and methods and standardize inventory management processes Establish inventory management post accountability system
Sales	Strengthen market research and promptly adjust sales strategies according to market changes Strengthen the management or bad debts or accounts receivable Where the accounts receivables cannot be recovered in whole or in part, the enterprise should find out the reasons, clarify the responsibilities, and handle the issues in strict compliance with the examination and approval procedures and pursuant to China 's uniform accounting standards
Research and Development	Establish a research achievement protection system, and strengthen the management of patents, non-patented technologies, trade secrets, as well as various kind or confidential drawings, programs and data formed during the R&D process Establish a R & D activity assessment system to enhance the comprehensive assessment of project initiation and research, and other process
Engineering Projects	Designate a special department to manage engineering projects on a centralized basis Select contractors and supervision entities based on merits for its engineering projects through open bidding
Guarantee	Designate relevant departments to be responsible for guarantee operations, conduct credit investigation and risk assessment of applicants, and issue written reports on assessment results Establish a guarantee accountability system, and strictly hold accountable the departments and personnel that made major errors in guarantee decision-making, fail to go through the collective examination and approval process, or fail to manage guarantee operations as required
Business Outsourcing	Establish and improve the business outsourcing management systems, specifying the scope, manner, conditions, procedures and implementation or business outsourcing, make clear the duties and authority of relevant departments and positions, and reinforce the monitoring of the entire outsourcing process

Financial Reporting	Hold financial analysis meetings on a regular basis, and make full use of the com comprehensive information reflected in the financial reports to conduct a thorough analysis of the operation and management situation and the existing problems of the enterprise, and constantly improve its operation and management level
Comprehensive Budgeting	Establish a budgeting management committee to perform the budgeting. Duties of comprehensive budgeting management Prepare an annual comprehensive budget hr adhering to its development strategies and annual production and operation plan by taking into comprehensive consideration the economic policies, market conditions and other factors during the budget period
Contract Management	Designate a centralized contract management department; specify the procedures and requirements for contract drafting, examination and approval, performance and aspects, conduct regular inspection and evaluation. Establish a contract performance assessment system, analyse and assess the overall situation of contract performance and the specific situation of the performance of major contracts at least once at the end of each year
Internal Informal Communication	Formulate a rigorous internal reporting process. Make full use of communication information technology, reinforce the integration and sharing of internal reporting information, and include internal reports into its unified information platform, so as to build a scientific internal reporting network Make effective use of internal reports in risk assessment, accurately identify and systemically analyse the internal and external risks in its production and operation activities, and determine the strategies to tackle such risks, so as to achieve effective control of risks
Information Systems	Designate a department to manage the building of information systems on a centralized basis Strengthen the management of critical information equipment such as the servers

Industry	Number	Ratio (%)	Number	Ratio (%)
Mining			7	10.4
Manufacturing				
Food and beverage	1	1.5		
Paper making and printing	1	1.5		
Petrochemical	2	3.0		
Metal and nonmetal	7	10.4		
Mechanical equipment	13	19.4		
Pharmacy	3	4.5		
Sub-total			27	40.3
Electricity			3	4.5
Construction			3	4.5
Transportation				
Railway transportation	1	1.5		
Highway transportation	4	6.0		
Water transportation	3	4.5		
Air transportation	3	4.5		
Supporting and auxiliary	1	1.5		
Sub-total			12	18
Information Technology			2	3.0
Finance and Insurance				
Banking	8	11.8		
Insurance	3	4.5		
Sub-total			11	16.3
Real Estate			1	1.5
Social Services			1	1.5
Total			**67**	**100%**

Table I.
Industry Distribution

Total revenue	Number	Ratio (%)
More than 10 billion	50	74.6
1 billion-10 billion	14	20.9
Less than 1 billion	3	4.5
Total	**67**	**100.0**

Table II.
Total Revenue of the 67 Cross Listing Companies

	Compliance	Number	Ratio (%)
Authenticity Statement	Yes	67	100
	Not disclosed	0	0
		67	**100**
Overview of Internal Control	Yes	62	93
	N/A	5	7
		67	**100**
Evaluation Evidence	Yes	63	94
	No	4	6
		67	**100**
Evaluation Scope	Yes in a separate section	52	78
	Yes not in a separate section	8	12
	Not disclosed	7	10
		67	**100**
Evaluation Procedures and Methods	Yes	59	88
	Not disclosed	8	12
		67	**100**
Deficiencies and Rectification	Detailed description of deficiencies	24	36
	Simple description of deficiencies	25	37
	No deficiencies disclosed	18	27
		67	**100**
Effectiveness and Conclusions	Yes	66	99
	No	1	1
		67	**100**

Table III. Compliance with Elements in Internal Control Evaluation Guidance

	Number	Ratio (%)
Significant Deficiencies	1	1.5
Important Deficiencies	2	3.0
General Deficiencies	46	68.7
No Deficiencies	18	26.8
Total	**67**	**100**

Table IV. Disclosure of Internal Control Weaknesses

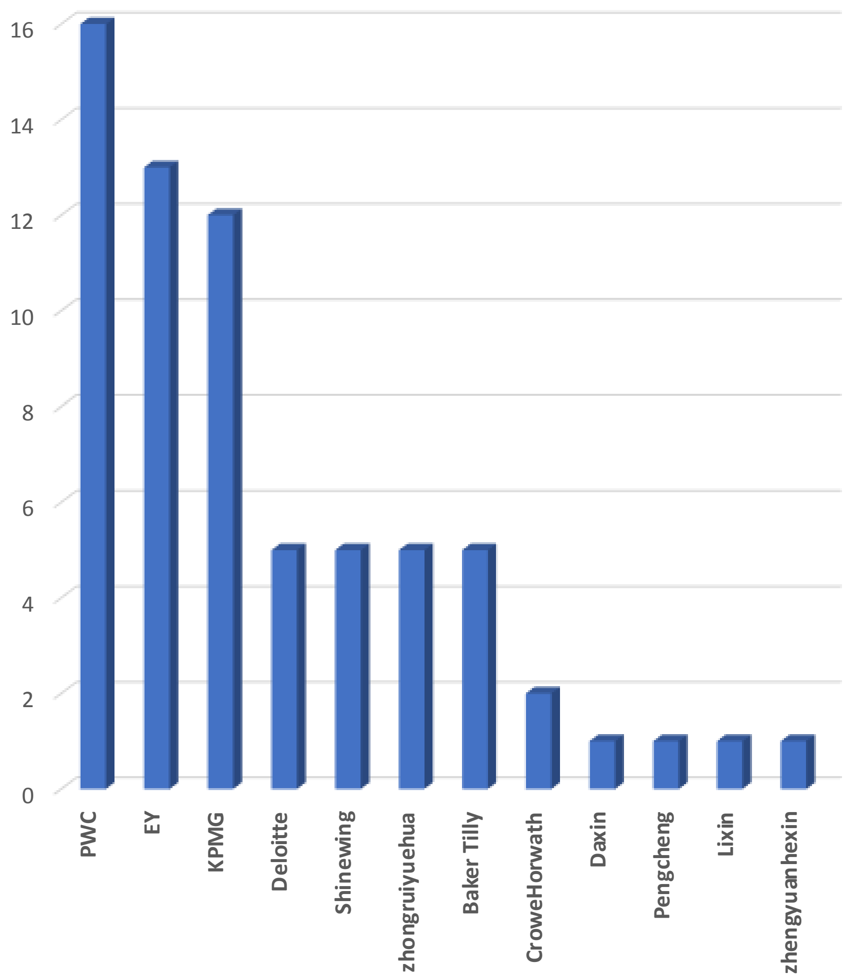

Figure I. Auditors of Internal Control Reports