

# Research on Internal Control Based on "Two assets" pressure——Case study of DT Company

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**Abstract:** Under the complicated domestic and international economic situation and the downward pressure of the larger domestic economy, the "Two assets" problem of China's manufacturing enterprises has become increasingly prominent. The large proportion of "Two assets" on corporate funds will greatly affect the operational efficiency of corporate cash flow, reduce business operating income, increase business risk, and constrain the long-term development of enterprises. Therefore, this article takes DT Company as an example, combined with DT's current "Two assets" situation and its predicament, and proposed corresponding countermeasures and suggestions for DT Company to improve "Two assets" pressure control management and strengthen internal control of enterprises.

## 1. Concept of "Two assets" Pressure Control

"Two assets" mainly refers to the accounts receivable and inventory of enterprises in the production and operation process, and the "Two assets" pressure control means to reduce the proportion of accounts receivable and inventory in total corporate funds as much as possible. To promote the liquidity of enterprises, maintain the vitality of funds, and improve the efficiency of the use of corporate funds, so as to achieve the ultimate goal of improving the operating income of enterprises.

In recent years, in the face of the gradual increase of economic downward pressure, the domestic market demand tends to fall back in the economic situation, and some industries have successively experienced problems such as overcapacity and poor connection between production and sales. With the continuous development of the market economy, the traditional manufacturing industry has been repeatedly subverted, and the profit rate of the company has been declining. In order to achieve the business objectives and maintain the profit rate of enterprises, many enterprises have begun to use the method of credit sales to open up the market, but While this model increases the market share of enterprises, it also increases the amount of accounts receivable as suppliers, which leads to potentially greater risk of credit risk for these companies. At the same time, the traditional manufacturing inventory production mode also makes inventory occupy a large amount of funds, reducing the utilization of corporate funds and affecting the quality of business operations.

## 2. The Importance of "Two assets" Pressure Control

According to the data, as of the end of the third quarter of 2014, the ratio of accounts receivable and inventory to the total amount of liquidity of the 113 central enterprises has exceeded 51.7%, more than half of the total liquidity, and is still growing[1]. Since the operating industries of state-owned and state-owned holding companies are mainly concentrated in the economic basic industries, they are also more affected by the "Three-phase superposition". The operating situation faced by state-owned enterprises is even more severe, and the pressure is correspondingly greater. Facing the economic situation that is not optimistic, the State-owned Assets Supervision and

Administration Commission has also fully deployed the work of the central government on the issue of “Two assets” pressure control, and in 2016, it has included “Strongly reducing accounts receivable and speeding up the clean-up of ineffective inventory” into the central enterprise’s work plan for improving quality and efficiency and performance evaluation index system for responsible persons of central enterprises[2].

For enterprises, the large amount of accounts receivable and inventory to the company's funds will make the liquidity of upstream and downstream funds tend to be tight in the operation of the enterprise. Once a node has problems, it will easily lead to instability or even the break of the capital chain of the enterprise. Which will brings a huge crisis to business operations. A large number of “Two assets” have a significant impact on the cash flow generated by the business activities of the company, and the cash inflow from operating activities ranks first among the three cash flows in the daily business activities of the enterprise, which is the daily production and operation activities of the enterprise and it is also the basis for the company's external expansion and an important indicator for judging whether a business is healthy or not. Therefore, enterprises should pay attention to the "Two assets" pressure control problem, and control the ratio of accounts receivable and inventory occupation funds within a reasonable range, ensure the effectiveness of internal control of enterprises, and promote the healthy and stable development of enterprises.

### **3. The Current Status of the Industry**

In recent years, there has been overcapacity in the global shipbuilding market, many shipyards have gone bankrupt or merged, and the shipbuilding industry has fallen across the board, in a difficult period of operation. As the market continues to shrink, the various shipyards compete with each other at low prices, which in turn affects the operation of companies that are compatible with shipbuilding.

DT's main business is the design and production of marine propellers, which is an important part of the ship supporting business segment. With the fierce competition in the ship market, the shipyard and shipowners' voice and bargaining power continue to increase. Shipyards will inevitably suppress the price of propellers and other ancillary markets due to their own cost pressures. At the same time, shipowners and shipyards have more and more strict on technology and quality, which makes DT companies face problems such as rising cost of quality and increasing risk of enterprises. DT company wants to continue to develop healthily, maintain business efficiency and efficiency in the current harsh industry environment, and ensure the flexibility of enterprise capital chain turnover, it must solve the problem of too high proportion of the "Two assets". Although as a traditional manufacturing enterprise, the proportion of accounts receivable and inventory in the funds is relatively high and reasonable and necessary, but for the long-term development of enterprises, only by combining internal control to regulate the production and operation of enterprises , establish and improve the internal control system, and effectively control the quality of the internal control of the enterprise, and control the proportion of the “Two assets” of the enterprise within a reasonable and stable range, so that the enterprise can adequate risk resilience to maintain good business and operational efficiency under the severe industry situation.

### **4. DT company's "Two assets" pressure control overview**

#### **4.1 The composition of DT company's accounts receivable and inventory.**

Up to september 2018 the DT's accounts receivable analysis is shown in Table 1. From the perspective of aging classification, the quality of accounts receivable is good, mainly concentrated within 1 year, the balance is 189,793,500 yuan, accounting for 91.98%; the total amount of accounts receivable for 1-2 years is 10,439,800, accounting for 5.06%. In 2-3 years, it was 43,572,400 yuan, accounting for 2.11%; the balance of accounts receivable for 3 years or more was small, which was 1,752,600 yuan, accounting for only 0.85%. From the perspective of type classification, all are sales receivables. From the perspective of debtor classification, the proportion of internal debts owed by

the group and the arrears of external company receivable were 47.75% and 52.25%, respectively, both of which were around 50%.

Table 1 Accounts Receivable Analysis

The aging analysis		
Aging	Amount[ten thousand yuan]	Proportion
Within 1 year	18979.35	91.98%
1-2 years	1043.98	5.06%
2-3 years	435.73	2.11%
over 3 years	175.26	0.85%
Type classification		
Classification	Amount[ten thousand yuan]	Proportion
Merchandise sales	20634.32	100.00%
Debtor classification		
Classification	Amount[ten thousand yuan]	Proportion
Group company internal arrears	9853.47	47.75%
External company arrears	10780.85	52.25%
Gross amount	20634.32	100%

Up to september 2018 the inventory analysis is shown in Table 2. According to the inventory age structure, most of them are concentrated within one year, and the balance is 110,965,400 yuan, accounting for 91.53%, and the inventory turnover is better. Inventories accounted for 8.47% over one year. Except for turnover materials, military products accounted for a large proportion of products (military production cycle is longer), and the backlog risk was small. From the inventory classification, the raw materials were 20,024,900 yuan, accounting for 15.39%; the products were 109,126,300 yuan, accounting for 83.89%; the turnover materials were 9,378,700 yuan, accounting for 0.72%.

Table 2 Inventory analysis

Inventory age structure		
Inventory age	Amount[ten thousand yuan]	Proportion
Within 1 year	11906.54	91.53%
1-2 years	280.33	2.15%
2-3 years	388.55	2.99%
over 3 years	433.57	3.33%
Inventory item type		
Classification	Amount[ten thousand yuan]	Proportion
Raw material	2002.49	15.39%
Semi-finished and finished products 成品	10912.63	83.89%
Reusable materials	93.87	0.72%
Gross amount	13008.99	100.00%

#### 4.2 The development of DT company's "Two assets" pressure control work and its difficulties.

In order to ensure the orderly development of the “Two assets” pressure control work, DT Company established the “Two assets” pressure control work special organization in 2016, and established the “Two assets” pressure control work leading group and “Two assets” pressure control work office, the office is affiliated with the finance department. The leading group is mainly responsible for the overall control and completion of the “pressure control” indicators throughout

the year. The office is mainly responsible for the daily work. The workshops of each department undertake the "pressure control" management and the reasonable turnover of funds and inventory in all aspects of production and operation. At the same time, DT Company revised the "Two assets Pressure Control Work Plan" in 2017, providing an effective system guarantee for the orderly implementation of the "Two assets" pressure control work.

Although DT has already developed a plan for the "Two assets" pressure control and has actively carried out a series of practical work, it also faces some difficulties in the process of implementation. First of all, in terms of accounts receivable, DT Company is facing a situation in which the ship market continues to be sluggish and the shipyard funds are tight. The difficulty of returning funds for enterprises is increasing. At present, the company's receivables are very strong, shipyard funding is tight in 2018, and the difficulty in returning funds will not be much improved, so the compression space for accounts receivable will not be too large. Secondly, in terms of inventory, the main raw materials of DT company's products are non-ferrous materials, and the market price of non-ferrous materials has continued to rise in recent years and has increased by a large margin. In 2018, raw material prices are expected to increase significantly compared with previous years. This means that on the basis of the production of the same products, the cost of the products will continue to rise, the amount of inventory will increase, and inventory control will be difficult. In addition, in the case of low product prices, in order to ensure the realization of income, the company will increase production, so the number of products will further increase. In summary, the pressure drop pressure faced by DT is very high.

## **5. Perfecting the DT company's "Two assets" pressure internal control**

### **5.1 Management of accounts receivable.**

Scientifically analyze and evaluate customers' credit risks and establish credit rating files. It is mainly reported by the Finance Department on the customer's payment status, responsible for the management of accounts receivable, and then the marketing department is responsible for evaluating the customer's credit rating and managing it. The customer's credit rating is mainly based on the client's capital background, collection rate, operating conditions and personnel changes in the company[3]. The Finance Department shall calculate the customer's arrears on a monthly basis and conduct annual accounts receivable statistics. After that, the Finance Department will conduct a comprehensive evaluation of the customer's payment with the marketing department. The marketing department should always pay attention to the customer's shipbuilding contract acceptance, ship construction delivery, and the increase or decrease of employees or subcontractors from various channels to judge the shipyard's operational risks. For shipyards that undertake contracts less than in previous years, encounter difficulties in shipbuilding delivery, and have large-scale layoffs, they should lower their credit ratings and increase risk prevention and control.

Establish a special assessment mechanism within the relevant departments. For the recovery of accounts receivable, the enterprise should establish a performance appraisal mechanism suitable for itself, implement the responsibility for collection to the department and person, strictly control the credit sales, clarify the main body of the collection responsibility, formulate the assessment criteria, and standardize the assessment methods. And after a period of time, the results of the assessment will be counted, excellent department or employee can get rewards. If the corresponding indicators are not completed, the department or individual will be punished. Through such reward and punishment mechanisms, the departments and employees will be mobilized, and the company will be able to better manage the accounts receivable

Strengthen the dynamic analysis of the receivables and form an early warning mechanism. To strengthen the integration of business and finance, the Finance Department should analyze the monthly collection, crediting and aging of accounts receivable, and communicate feedback to the business department in a timely manner. After sorting out, to enterprises in the credit period we should still pay close attention to whether their business conditions and repayment ability have changed greatly, and make reasonable plans in time. For enterprises that have not paid their debts

overdue, the frequency of communication should be strengthened. If the other party is a long-term cooperative credit customer, we can give them appropriate repayment pressure while maintaining good relations. For companies with larger amount of arrears and longer aging, we should be promptly reported to the marketing department, and timely press for payment of the debt. If it is unsuccessful, legal means can be used to recover the money when it is necessary to avoid the generation of bad debts and the company brings losses.

## **5.2 Management of inventory.**

Based on the actual situation, develop a reasonable business plan. The marketing department, production management department and material department should strengthen communication, in order to timely grasp the order situation, rationally formulate production plans and procurement plans, effectively implement the work strategy of “selling production by production and production by production”, continuously optimize production and procurement arrangements. At the same time as ensuring normal operations, efforts are made to reduce the input of excess production factors. Enterprises should strengthen control from the source, and strengthen market situation judgment, rationally arrange purchase, production, and sales convergence plans, improve procurement models, integrate internal supply chain management, strictly verify inventory physical quantity and value inventory levels, focus on clearing excess inventory, and reduce inventory cost.

Strengthen internal control in the inventory management process to ensure that ineffective inventory is cleared in a timely manner. A post responsibility system should be established to rationally allocate inventory management and clarify the responsibilities and authorities of each department. The Finance department shall conduct regular spot checks and inventory on inventory, speed up the cleanup and disposal of damaged and scrapped inventory. And organize special personnel to make profit through clearance, internal adjustment, price reduction promotion, centralized disposal, and public auction and so on to maximize the recovery of invalid inventory to recover funds, shorten the inventory turnover period, and accelerate capital turnover.

Establish an information system platform for inventory management to manage enterprise inventory[4]. Combined with modern management methods, the inventory management of enterprises can be faster and more efficient, and the efficiency of enterprise inventory management can be improved. Enterprises can use the ERP system to establish a management platform. Each department can directly exchange information on inventory management information on the same platform as long as relevant information is entered, avoiding the cumbersome communication process in offline work and avoiding information distortion and delay that may occur during the transfer.

## **6. Summary**

In summary, the “Two assets” pressure control is particularly important and necessary for enterprises. Enterprises should start from the source, understand the reasons for the high receivables and inventory, and strengthen their management and improvement with their own reality, improving the corporate system, correcting operation procedure, fully mobilizing the enthusiasm of all parties to control the “Two assets” within a reasonable range, thereby ensuring the vitality of corporate liquidity and improving the operational efficiency of enterprises.

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