Internal control and accommodation in Chinese organisations

Jenny (Jing) Wang*, Keith Hooper

Department of Accounting & Finance, Unitec Institute of Technology, Private Bag 92025, Auckland 1142, New Zealand

ARTICLE INFO

Article history:
Received 2 March 2016
Received in revised form 24 April 2017
Accepted 27 April 2017
Available online xxx

Keywords:
Critical
Corruption
Management control

ABSTRACT

Internal control is conventionally depicted as comprising technical practices designed to prevent or detect accounting errors and/or the loss of assets. However, high profile corporate collapses in recent years have fostered a recognition that internal control encompasses an organisation's broader cultural milieu. The paper argues that internal control may be ineffective regardless of the technical routines in place when an apparent acceptance of managerial discourse and managerial intentions is undermined by accommodation. The focus is on the hotel industry in China where junior staff is recruited from the ranks of internal migrants seeking work in the cities. Unprotected by unions or labour laws, such staff creatively cope with their situation by accommodation rather than overt resistance. Internal control systems in Chinese organisations outwardly reflect traditions of obedience, but various forms of accommodation serve to weaken the surface illusion of docility. The paper is illustrated with cases drawn from the researcher’s experience as a trainee manager. Theoretical guidance is provided by Foucault’s concepts of power/knowledge, discipline and subjugated knowledges: local memories regarded as unqualified or actively disqualified within scientifi city.

1. Introduction

The objective of this paper is to show how internal control weaknesses (ICW) may come about within organisations from accommodation at the micro level of human behaviour. Traditionally, internal control has been depicted as comprising the technical practices and routines that assist in protecting an organisation’s assets and the integrity of its accounting records as well as fostering efficient and effective operations and regulatory compliance. For example, Australia’s Auditing and Assurance Standards Board (AUASB) provides the following definition of internal control in its Glossary (AUASB, 2009, p. 24):

Internal control means the process designed, implemented and maintained by those charged with governance, management and other personnel to provide reasonable assurance about the achievement of an entity’s objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations. The term “controls” refers to any aspects of one or more of the components of internal control.

In this way, internal control is often focussed on technical processes, such as the segregation of incompatible functions, appropriate authorisation of transactions, timely reconciliation of accounts, and such. However, this paper contends that effective internal control is about more than just process. Rather, effective internal control must encompass a broader range of fundamental aspects concerned with how an organisation operates. This has been highlighted by high profile corporate
collapses – most notably Enron – where the fundamental weaknesses in internal control did not relate primarily to technical processes, but rather to the broader control milieu of the organisation (Krishnan, 2005). In particular, in settings where there is an unquestioning allegiance to senior management or where decisions cannot be challenged and probing questions are discouraged, then internal control may be ineffectual, regardless of the extent and quality of the technical routines in place.

In relation to the governance of behaviour generally, Foucault (1980b, p. 82) refers to the concept of “subjugated knowledge”: “local memories regarded as unqualified or actively disqualified within the hierarchies of sciﬁcency”. Further, he states that adopting this notion in conducting an analysis at the micro level “allows us to establish a historical knowledge of struggles and to make use of this knowledge today” (p. 82). While there is an extensive literature on internal control systems, and the prevalent weaknesses within such systems, the general approach adopted in identifying control weaknesses is structured from a macro perspective. Consideration of internal control weaknesses from a micro and historical perspective is rarely featured.

A micro perspective can highlight that while accounting provides a structure of ﬁnancial goals, budgets and performance measures, the implementation of control, as shown by Hopper and Macintosh (1998), becomes the agency of managers. As a consequence, under a culture of obedience, implementation can permit managers to pursue fraudulent or self-advantageous practices and require “people lower in the hierarchy to do whatever it took” (“A Load of Tosh”, The Economist, 2015, p. 50). This paper argues that within Chinese Confucian dominated cultures, scant attention has been given to how internal control weaknesses may often be a manifestation of distinctive behavioural and cultural perspectives.

A notable example of this occurred at Toshiba, where a long term fraud that inflated proﬁts by around $1.2 billion was blamed on management having “relied on a Japanese culture of obedience” (“A Load of Tosh”, The Economist, 2015, p. 50). At Toshiba, as reported in The Economist, the long running fraud was perpetrated from the top and was successful because staff at lower levels facilitated the fraud by following a Confucian culture of obedience. This requires obedience to superiors even when they are known to be in the wrong. It is argued that this Confucian legacy is also persistent in China. This ongoing relevance of the Confucian legacy today is identiﬁed by Hammond and Richey (2015) in their recent book The Sage Returns. However, its inﬂuence on – and potential undermining of – internal control systems is unlikely to be pinpointed by macro determinants of probability, such as market capitalisation, ﬁrm age, aggregate loss, bankruptcy risk, number of operating divisions, sales growth, restructuring charges and governance. Firms scoring high probabilities of weakness on these variables are deemed to be relatively more distressed and have lower market values, greater complexity of operations, higher incidence of organizational change and greater accounting measurement risk (Doyle, Ge, & McVay, 2007).

This paper argues that at the micro level, a determinant of internal control weakness in organisations can be a culture of obedience to authority, coupled with staff seeking preferment by accommodation. Such accommodation is embedded in the Confucian legacy so that while obedience and harmony to authority is paramount the practice of “guanxi” persists. The paper shows how “guanxi” can arise by accommodation creating a sense of mutual obligation which may undermine overt internal controls. Rosenheck (2014) reports that North American exchanges have de-listed more than 100 Chinese ﬁrms in recent years because of accounting problems. Chinese Integrated Energy and Sino Forest are among Chinese companies de-listed. The two have in common related party transactions and fraudulent practices being successfully concealed from auditors (respectively KPMG & E&Y). These cases involve in common, a culture of obedience which reﬂects the Confucian tradition of collective harmony. It is a harmony built on respect for authority and a need for juniors to accommodate to the wishes of their seniors. Of course, similar scandals appear in Western countries but where similar situations apply they lack the same cultural reinforcement.

Hung, Wong, and Zhang (2012) researched 212 corporate scandals linked to companies trading on Shanghai and Shenzhen markets between 1997 and 2005 and found that such frauds, besides being commonplace, cause on average only an 8% drop in share price but where government or government officials are involved prices fell by almost a third. The reason for the difference is that audited accounts are not valued by Chinese investors, while relationships whether political or social are viewed as more important than numbers. Lin, Cai, and Li (1996) point out that non-state ﬁrms in China need to build connections with government in order to obtain favours. The paper argues that staff too are affected in the same way as investors: numbers are not important but maintaining relationships with authority is. Thus, obedience to the intentions of management with connections is paramount for staff. Such ﬁndings by Hung et al. (2012) explain why managers may sacriﬁce faithfulness to their internal controls to promote relationships and why the Big Four auditors may ﬁnd that obtaining answers to questions difﬁcult.

E & Y, the auditors of Sino Forest paid out $117 million to settle investor lawsuits. PWC’s investigation into Sino Forest has been frustrated because of difﬁculty in getting in gathering data. The Canadian Globe and Mail of 3 September 2011 report, “The shifting stories and details lost in time – as well as the company’s apparent effort to control what is said by whom – highlight the difﬁculties faced by those looking to ﬁnd the truth” (p. 5). The point is that breaches of internal controls were enabled by silence.

To summarise, the problems involving these two companies are arguably cultural in the sense that the Chinese practice of “guanxi” clashes with the concept of arms-length business practices, while controlling what is said and what is not said goes beyond the Communist revolution to the Confucian ideal of harmony. This included, in 2010, the ﬁrm Chinese Integrated Energy Ltd – a KPMG audit client which reported that it had a biodiesel factory that was in full production, but which in reality had been dormant for months. Sino-Forest, audited by Ernst and Young, claimed to own timber that did not actually exist. In each case, 95 per cent of the value of the companies was fictitious, but the auditors were unable to uncover the true situation. Sino Forest audit investigations were delayed by concealment, employee silence and a loss of memory.
دریافت فوری متن کامل مقاله

امکان دانلود نسخه تمام متن مقالات انگلیسی
امکان دانلود نسخه ترجمه شده مقالات
پذیرش سفارش ترجمه تخصصی
امکان جستجو در آرشیو جامعی از صدها موضوع و هزاران مقاله
امکان دانلود رایگان ۲ صفحه اول هر مقاله
امکان پرداخت اینترنتی با کلیه کارت های عضو شتاب
دانلود فوری مقاله پس از پرداخت آنلاین
پشتیبانی کامل خرید با بهره مندی از سیستم هوشمند رهگیری سفارشات