

# Research on Internal Control of Accounts Receivable in Small and Medium-sized Construction Enterprises

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## Abstract

With the fierce competition in the current construction market and the influence of the COVID-19, the living space of small and Medium-sized construction enterprises is shrinking. At the same time, the small and Medium-sized construction enterprise accounts receivable internal control has many problems, leading to ocean of receivables, bad debts of accounts receivable and cash flow difficulties, which dramatically increases the business risk of enterprises. Therefore this paper analyzes the problems of the internal control of accounts receivable in small and Medium-sized construction enterprises and gives some corresponding solutions.

## Keywords

Small and Medium-sized Construction Enterprises; Accounts Receivable; Internal Control; Problems; Measures.

## 1. Introduction

As the construction market has become increasingly saturated and the pandemic has caused huge adversary influence in recent years, the construction enterprises, especially small and Medium-sized construction enterprises suffer more difficulties, such as shortage of funds and tough recovery of accounts receivable. However, small and Medium-sized construction enterprise accounts receivable internal control is often overlooked, which result in collecting accounts receivable more slowly, generating a large number of bad debts and even causing bankruptcies of these enterprises. Therefore, I will analyze present situation of internal control of small and Medium-sized construction enterprises to find some significant problems and propose corresponding solutions to help small and Medium-sized construction enterprises get through the tough time and achieve further development.

## 2. Analysis of the Current Situation of Accounts Receivable Internal Control in Small and Medium-sized Construction Enterprises

### 2.1. Characteristics of Construction Industry

#### 2.1.1. Widely Distributed Projects and Long Construction Period

The main business of construction enterprises is often not completed in the location of enterprises, but all over the country. Moreover, the construction period of the project is very long, because the project itself needs a lot of manual labor and material resources, the needs of the party A are different and the construction process will encounter various problems.

#### 2.1.2. Large Advance and Long Collection Period

Construction enterprise investment is large, while party A's capital is limited and often cannot pay off in a lump sum. Construction enterprises often express that they are willing to advance

in order to succeed in bidding, which brings a large number of accounts receivable. The construction period of the project is very long, and the project payment is paid according to the contract or the completion progress of the project. On the one hand, Party A delays the payment of the receivables due to the lack of payment ability, dissatisfaction with the project and other reasons. On the other hand, due to the low efficiency of enterprise information transmission, most construction enterprises' receivables collection period is long.

## **2.2. Internal Control Status of Accounts Receivable in Small and Medium-sized Construction Enterprises**

### **2.2.1. Control Environment**

#### **● Business culture**

Small and Medium-sized construction companies generally have the business culture—emphasizing engineering over management, so the whole company regards the quantities of engineering as the standard of the company's performance.

#### **● Organizational structure**

The organizational structure of small and Medium-sized construction enterprises is divided into three levels: the first level is the board of directors; The second level is general manager; The third level is each functional department, respectively for the purchase department, engineering department, expense control department, financial department.

### **2.2.2. Risk Assessment**

Small and Medium-sized construction enterprises have no special credit management department and the staffs of the expense control department give customers credit limits without assessing the internal and external risks of the enterprise. In order to obtain more projects, the staff of the expense control department will accept new customers even if their reputation is not very good. As for old customers, they are mainly based on their past knowledge without checking their present reputation.

### **2.2.3. Control Activities**

#### **● Prior control**

The cost control department is responsible for the prior control and the performance of the cost control department staffs is linked to the amount of contracts signed. In the bidding process of projects, in order to win the bid, they often ignore customers' credit and future payment ability and blindly bid at a low price.

#### **● In-process tracking**

The main control in the construction process is the advance of the material payment. In the process of construction, in order to complete the project on time, the project materials will be paid in advance. In the actual operation, the staff of the expense control department lacks the ability to investigate customers and relevant financial knowledge, so the payment of engineering materials often cannot be collected in time.

#### **● Post control**

The engineering department informs the financial department that the project payment has been completed according to the progress appointed in the contract and the financial department can ask for the project payment. Then the financial department will make the project payment receivable table according to the information informed by the engineering department and clear the project payment. The entire financial department is responsible for the collection and management of accounts receivable and no specialized person is designated to take charge of each project. The performance of financial department staffs has nothing to do with accounts receivable collection.

#### **2.2.4. Information and Communication**

Small and Medium-sized construction enterprises do not have a unified communication platform. After the formation of receivables, the engineering department will notify the financial department. The financial department is responsible for collecting the receivables. If the receivables have been collected, they do not notify the engineering department. If the receivables have not been collected, they report to the upper level to decide whether to stop construction, and then notify the engineering department.

#### **2.2.5. Internal Supervision**

Small and Medium-sized construction enterprises do not set special internal audit departments, but only select one or two accountants of the financial department to conduct internal audit of accounts receivable internal control.

### **3. Problems of Internal Control of Accounts Receivable in Small and Medium-sized Construction Enterprises**

#### **3.1. Most Managers do not Pay Attention to the Internal Control of Accounts Receivable**

Small and Medium-sized construction companies generally have an "ignorance of engineering management" enterprise culture. They think gaining enough projects is the primary task of the company, which is easy to leading to the company's focus being fully on the project and ignoring the management of accounts receivable. Accounts receivable internal control is only a formality and managers lack awareness of the importance of receivables collection.

#### **3.2. Lack of Credit Management Department**

Small and Medium-sized construction enterprises do not have a specialized credit management department, resulting in blind credit sales without comprehensive assessment of internal and external risks when giving the credit limits to customers. Excessive relaxation of credit limits for new customers, enterprises will greatly increase the difficulty of late receivables recovery and probability of enterprise receivables bad debt. For old customers, these enterprises do not update their credit information in time, which will lead to enterprises relying too much on the early information and ignoring the receivables management of old customers. Even if old customers are on the verge of bankruptcy, they cannot perceive in time, causing enterprises to suffer significant losses.

#### **3.3. Weak Internal Control of Accounts Receivable**

The control process of accounts receivable is divided into three parts: prior control, in-process tracking and post control, but small and Medium-sized construction enterprises have not done a good job in these three parts. For prior control, expense control staffs ignore customer credit because their performance has nothing to do with the collection of accounts receivable, which will cause difficulties in the later collection. For in-process tracking, the staffs of the expense control department lack the ability to investigate customers and relevant financial knowledge, blindly believe in customers' repayment ability and help customers to pay for their debts in advance, which lead to an increasing amount of enterprise receivables. For post control, the whole financial department is responsible for the collection of receivables. The receivables are not corresponding to individuals and linked with individual performance, which easily causes the situation of shirking responsibility, and failure of the internal control of receivables.

#### **3.4. Slow Information Flow and Low Communication Efficiency**

Small and Medium-sized construction enterprises' engineering projects are distributed all over the country. There are many communication links and no unified communication channels.

Information transmission between various departments of the company is not timely, which leads to low efficiency and effects of internal control of accounts receivable. Furthermore, it will affect the statistics and timely recovery of accounts receivable.

### **3.5. Lack of Specialized Internal Supervisory Department and Professional Staffs**

Many small and Medium-sized construction enterprises do not have specialized internal audit departments, but only select one or two people from the finance department to conduct internal audit. This practice seriously undermines the independence of audit and is not in compliance. Moreover, most accountants lack professional and systematic knowledge of auditing and cannot conduct a comprehensive audit of accounts receivable, which leads to many problems of internal control of accounts receivable that cannot be found out.

## **4. Solutions to Internal Control Problems of Accounts Receivable in Small and Medium-sized Construction Enterprises**

### **4.1. Create a Good Internal Control Environment**

The management should change traditional ideas, not only to increase in the number of accounts receivable, but also to improve the quality of accounts receivable. They are supposed to consider the future collection of accounts receivables at first when signing a contract. At the management meeting, they can not only focus on the value of the contracts, but also analyze the current collection of the number of accounts receivable and predict collection of next periods. Then identify the cause of discrepancy between the planned and the actual and take action.

### **4.2. Improve the Organizational Structure**

Firstly, Establish a specialized credit management department. The department has a customer credit evaluation specialist, who is responsible for collecting customer credit information through multiple channels and sets up specialized files to rate customers. Select risk assessors, responsible for assessing the situation of enterprise and customer and give a certain amount of risk coefficient for each level of customers. Select customer credit examiners to regularly review the data in customer credit files to ensure that the data in the files are updated regularly. Select information collection staffs, who timely transfer customer credit information to expense control department, finance department, engineering department and other relevant departments. Select collection staffs, who according to the due time of the payment, and the customer's current rating, decide the strength of the payment and the way of payment.

Secondly, establish a special internal audit department. The department is responsible for the continuous monitor of the enterprise's accounts receivable internal control, individual evaluation and regular reports on defects, especially major problems of the internal control of accounts receivable. They need to put forward targeted suggestions for improvement and improve the enterprise's accounts receivable management efficiency.

### **4.3. Strengthen the Control of Accounts Receivable**

For prior control, the expense control department decides whether to bid or not according to the customer files of the credit management department, and evaluates the performance of the expense control department according to the amount of receivables recovered and the amount of contracts. For in-process tracking, the expense control department decides whether to advance capital for the customer according to the customer credit rating given by the credit management department. For post control, the receivables are distributed to the corresponding debt collectors according to the project and performance assessment of the debt collectors is appraised by the actual amount of the final receivables recovered to the expected amount recovered ratio.

#### 4.4. Establish and Improve the Information Sharing Platform

Small and Medium-sized construction enterprises can build an accounts receivable module in ERP system. Each department can attain information about accounts receivable through the system and the relevant staffs approved by the superior can update relevant information. The platform reduces the communication cost and improves the efficiency of information flow and removes barriers to information communication between departments.

When establish an information sharing platform, the internal audit department should strengthen the account receivable the internal control. The board of directors and managers should pay sufficient attention to decentralization and authorization. Without approval and authorization, any staff must not view and deal with relevant economy business and even change the information, or they will destroy the authenticity and effectiveness of information and cause a great loss for the whole enterprise. In addition, the enterprises should strengthen information security protection and prevent the leakage of relevant information.

#### 4.5. Improve the Quality of Staffs Related to Accounts Receivable Internal Control

The quality of accounts receivable internal control depends on the professional quality of staffs to a large extent. Personnel department of small and Medium-sized construction enterprises can strengthen the quality of staffs from the perspective of recruitment, training and so on, which can improve the implementation effect of accounts receivable internal control.

Firstly, the small and Medium-sized enterprises can increase salary and treatment to attract high-quality talents. In term of the lack of accounts receivable management and audit knowledge of internal control, high salaries can be offered to staffs with professional knowledge and rich experience from external firms or other channels to improve accounts receivable internal control and the quality of accounts receivable.

Secondly, the small and Medium-sized enterprises can regularly train the management, especially staffs related to internal control of accounts receivable to help them understand the importance of internal control of accounts receivable, credit control of accounts receivable, accounts receivable collection skills and so on.

### 5. Conclusion

To sum up, small and Medium-sized construction enterprises are facing serious internal and external troubles—fierce competition in the external market and weak internal management ability, especially the internal control of accounts receivable. In the changeable external environment, how to improve the quality of accounts receivable is the primary problem that small and Medium-sized construction enterprises need to solve. Enterprise managers should not only focus on market share, but strengthen the account receivable the internal control through optimizing the internal control environment, perfecting the organizational structure, strengthening the accounts receivable control, establishing the information sharing platform and enhancing the quality of staffs related to accounts receivable internal control to improve the level of enterprise accounts receivable internal control, speed up the accounts receivable to recover, improve the turnover of funds and promote the sustainable and healthy development of small and Medium-sized construction enterprises.

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