

Sino-Petrochemical Internal Control Effectiveness——From the Sinopod “Black Swan” Event

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Abstract: At present, the internal control construction and research of Chinese enterprises have achieved considerable development in practice and theory. There are not only a few cases where the internal control system has a sound internal control system but the actual implementation is not very optimistic. Taking the huge loss of the joint petrochemical crude oil as an example, this paper evaluates the implementation of its internal control with the operating results of Sinopec Group, and analyzes the effectiveness of its internal control from the perspective of five elements of internal control, and affirms its policy of continuous high dividends. The effectiveness of internal controls. Finally, from the perspective of five elements, suggestions are made to improve the effectiveness of Sinopec internal control.

1. Case analysis

1.1 Case introduction

United Petrochemical is a wholly-owned subsidiary of China Petroleum & Chemical Corporation and the largest international trading company in China. The business scope of United Petrochemical includes four major sectors including crude oil trade. On December 27, 2018, there were media reports that the “Black Swan” incident in which Union Petrochemical suspected a huge transaction loss, the main responsible person had been suspended. As of December 27, the price of oil futures has fallen to \$53. Affected by this news, the stock price continued to fall after the opening of Sinopec on the afternoon of the 27th, and the market value of the closing on the 28th was nearly 70 billion yuan. Sinopec immediately issued a statement saying that Sinopec caused some losses due to the fall in oil prices during certain crude oil trading and is assessing the specific situation. Mr. Chen Bo, General Manager of United Petrochemical, and Mr. Zhan Jun, Secretary of the Party Committee, were suspended for work reasons. On January 25, 2019, Sinopec issued a report on the progress of the investigation, stating that in the daily supervision process, the financial indicators of the joint petrochemical hedging business were found to be abnormal. In 2018, the joint petrochemical operation suffered a loss of approximately RMB 4.65 billion.

The “black swan” event refers to something that is difficult to predict and unusual, and often causes negative reaction or even subversion of the market chain. It is accidental, it has a major impact, and although it is accidental, it is considered more or less interpretable and predictable.

1.2 Analysis of the effectiveness of internal control of Sinopec

(1) Evaluate the effectiveness of internal control with quantitative indicators

The main financial indicators of Sinopec in 2018 are shown in Table 1:

Table 1. 2018 Sinopec main financial indicators

Main financial indicators	2018-12-31
Sales margin	2.78%
Return on assets	73.27%
Roe	8.78%
Cash ratio	29.56%
Assets and liabilities	46.14%
Inventory turnover	12.93%
Total asset turnover	1.81%
Main business income growth rate	22.50%

On the basis of considering the development level of the petrochemical industry as a whole, the weight of Sinopec's financial operation characteristics and industry development report is determined. The solvency index, operational capability index, profitability index and development capability index respectively account for 20%, 20%, 50%, 10%.

Calculate the score of Sinopec's financial indicators according to the formula:

$$\begin{aligned}
 Y &= (Y_1 Q_1 + Y_2 Q_2 + \dots + Y_N Q_N) * 100 \\
 &= [(0.2956 + 0.4614) * 20\% + (0.1293 + 0.018) * 20\% + (0.7327 + 0.0278 \\
 &\quad + 0.0878) * 50\% + 0.2250 * 10\%] * 100 \\
 &= 62.75
 \end{aligned}$$

(2) Analysis of the effectiveness of internal control of Sinopec

Internal environmental effectiveness analysis. It is not uncommon for the company's senior management to concentrate on the governance structure. Chen Bo, Chairman of United Petrochemical, has been working within the China Petrochemical Group since graduating from the Huadong Institute of Chemical Technology (now East China University of Science and Technology). He is an "old river" in the oil field. In the year when Union Petrochemical was founded, Chen Bo joined and successively promoted the business directors of several Sinopec overseas companies. The chairman of Union Petrochemical has close ties with the management leadership team. The board members and management have listened to Chen Boyan's actions, and its supervisory role has been seriously weakened, which has caused the management's power to lose effective checks and balances and supervision, resulting in serious internal control. Many large state-owned enterprise executives in business management have an important position in business management. With his many years of experience in the international crude oil procurement market, Chen Bo has made more oil futures at the oil price of more than 70 US dollars per barrel, buying 30-70 million barrels and bullish crude oil prices all the way. However, the international oil price fell to around US\$42 per barrel in November and December. Chen Bo's intention to go his own way and misjudge the international oil price eventually led to a huge loss of 4.65 billion yuan for United Petrochemical.

Risk assessment effectiveness analysis. The main point is that there is not enough emphasis on external risks. Unlike the CAO incident, the purpose of the joint petrochemical hedging is to hedge the risk of crude oil futures trading. Since the company's main business is to purchase imported crude oil for the parent company Sinopec, it will hoard crude oil for a long time, and hedging transactions will help reduce risks. Therefore, the focus of Sinopec management should be on controlling the inventory impairment of enterprises. And Union Petrochemical Chen Bo believes that the price of crude oil is normal at 60~80 US dollars per barrel, and it is holding a bullish attitude. Like his point of view, investment banks such as Bank of America Merrill Lynch and Barclays Bank also saw rising oil prices. But even on the basis of an external view of consistently bullish oil prices, United Petrochemical bought a large number of crude oil bullish futures at a price of more than US\$70 on the basis of one person's judgment, indicating that it has serious deviations from the risk assessment. The world oil price is highly variable. If the oil price falls, it will cause a large amount of impairment of crude oil inventories. This is the case, as the oil price has fallen to \$53 a barrel by the end of December. It is precisely because the risk assessment of the joint petrochemical management is not in

place that the assessment and the corresponding risk response measures should not be done before such a large-scale purchase, which has caused Sinopec's market value of up to 70 billion to evaporate.

(3) Analysis of the effectiveness of control activities

As a large state-owned enterprise, Sinopec has the following special problems in its control activities: First, the process of controlling activities is backward. Sinopec has been following the revised internal control system in 2011. The control of business processes and management processes has not been updated frequently. It lacks sufficient attention and control over risk points, making internal control lack of foundation, effective and operational internal control system is incomplete. Moreover, the execution of control activities is not enough, there are rules that do not follow the rules, system failure, strict punishment, and weak internal control.

(4) Analysis of information and communication effectiveness

Effective communication includes top-down, horizontal, and bottom-up communication throughout the enterprise. The main problem with Sinopec's information and communication is the lack of bottom-up communication. The intentions and institutional regulations of the superiors are easy to lay down, and the discussion and communication between the horizontal levels is relatively easy. However, in the bottom-up communication, such as the CAO incident, Chen Jiulin uses the information superiority to achieve the alert. When the line was \$500,000, it was not reported, and even every effort was made to conceal losses and conduct fraud. The final loss was too large to be concealed, which greatly damaged the interests of the group.

2. Suggestions on improving the effectiveness of internal control of Sinopec

2.1 Improve the internal environment

The management of the enterprise should constantly observe the operation of the internal control of the enterprise, and make timely adjustments to the changes of the internal control environment, and timely discover and make up for the defects in the internal control of the enterprise. Sinopec, a large state-owned holding company, has a sound internal control system. Therefore, improving the internal environment should start with internal personnel, improve the internal control awareness of each employee, establish an internal control culture of integrity, and form a benign cultural atmosphere.

2.2 Do a good job in enterprise risk assessment

Enterprises with such large inventory in Sinopec should strengthen risk assessment, monitor market changes from time to time, use some financial hedging methods to reduce losses caused by fluctuations in crude oil prices, and reduce the occurrence of similar joint petrochemical incidents. At the same time, employees as the main body of the enterprise should also raise their awareness of risk prevention, report the risks to the higher level in a timely manner, and jointly resist the risks for the enterprise.

2.3 Strengthen corporate control activities

The division of duties and responsibilities is clear, and each department supervises each other, which is the most important measure to strengthen corporate control activities. When setting up a position, enterprises can never ignore the requirement of separation of incompatible positions, and avoid the enterprise being controlled by one person or group. The reason for the mistake in the judgment of crude oil price is because it is too much to believe that Chen Bo is the old river. "The judgment." Therefore, Sinopec should clarify the distribution of power to ensure that everyone in the key positions can use their duties and duties reasonably and correctly. The major issues cannot be decided by one person.

2.4 Establish a smooth communication channel

According to the theory of investor protection, the relationship between investors and internal control is utilized, while the internal control is disclosed in a timely manner, and the interests of other shareholders are also protected. The responsibilities of the board of directors and management should

be improved, the principles of information disclosure should be clarified, and responsibilities can be clarified when defects occur. Ensure that the quality of information disclosure meets the requirements of regulatory agencies and meet the information requirements of investors and creditors. At the same time, Sinopec should use CAO as a reference to improve the operational efficiency of the bottom-up information system and further improve the efficiency and effectiveness of internal control management.

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