

# Internal Control Measures of Rural Commercial Banks Based on Risk Management

Qi Shao<sup>1,2</sup>

<sup>1</sup>Business Development Department, Shandong Linyi Luozhuang Rural Commercial Bank Co.,Ltd., Linyi, Shandong, 276000, China

<sup>2</sup>Philippine Christian University Center for International Education, Malar, 1004, Philippines

**Abstract:** Based on the background of economic globalization, to solve the new problems faced by internal control of commercial banks, this paper analyzes the current situation of internal control of rural commercial banks, and based on risk management theory, analyzes the relationship between internal control and risk management of commercial banks. It is believed that there are still shortcomings in the internal control of rural commercial banks, such as incomplete credit rating systems, outdated internal control systems, and low efficiency in information internal transmission, insufficient internal regulatory system and other issues. Starting from risk management, proposing internal control measures for rural commercial banks requires strengthening credit rating systems, strengthening the construction and implementation of internal control systems, constructing safe and efficient information communication channels, and improving internal regulatory mechanisms, aiming to help rural commercial banks enhance their comprehensive strength in risk prevention.

**Keywords:** risk management; commercial banks; internal controls

## 1. Introduction

China's financial industry is developing rapidly, with large commercial banks taking the lead. Due to the high concealment of lending risks faced by banks and the increasingly complex financial environment, commercial banks have been unable to improve and adapt their risk management and internal control measures, making the banking industry a focus of attention. For commercial banks in China, risk management and internal control are both very important contents, but in reality, the development of these two is still relatively lagging behind. The "Enterprise Risk Management - Integrated Framework" released by COSO combines the concepts of risk management and internal control, which has a profound impact on the development of commercial banks<sup>[1]</sup>. Observing internal control issues in commercial banks based on risk management can help enterprises reflect the concept and content of risk management. At the same time, building internal control activities from the perspective of risk management can help commercial banks guide their long-term development strategy and risk management goals, making the construction of internal control activities more strategic and purposeful. Integrating risk management with internal control is of great significance for rural commercial banks to strengthen their management and operational capabilities.

## 2. Theory of Internal Control Risk Management in Commercial Banks

In the latest "Guidelines for Internal Control of Commercial Banks" issued in 2014, China provided the latest expression on the meaning of internal control of commercial banks, which refers to the dynamic process and mechanism of the board of directors, supervisory board, senior management, and all employees of commercial banks participating in the development and implementation of systematic systems, processes, and methods to achieve control objectives<sup>[2]</sup>. In September 2004, COSO issued the "Integrated Framework for Enterprise Risk Management" (COSO-ERM), which provides an authoritative definition of risk management. The definition of enterprise risk management is to identify and manage issues that affect the normal operation of the enterprise. Risk management in commercial banks refers to the adoption of a series of methods to identify and analyze risks, and ultimately control them, in order to ensure the safety of commercial bank funds and reduce or even avoid economic losses.

Risk management focuses more on regulatory foresight and a certain level of strategy, analyzing the

issues that have an impact on the daily activities of commercial banks, utilizing those that are beneficial to the enterprise as strategic adjustments, and taking corresponding measures to control unfavorable factors. This approach of comparing the risks and rewards of different businesses maximizes benefits, so risk management has strategic characteristics. Internal control involves adopting a series of specific methods and means to achieve goals in business management activities. It is not difficult to see that internal control has strong real-time performance and a certain degree of lag.

### **3. The Necessity of Conducting Internal Control Work in Rural Commercial Banks**

#### ***3.1. Reducing Market Operational Risks in Commercial Banks***

Under the market economy system, commercial banks, like other market entities, also bear high market operational risks, including currency risks, operational risks, etc. Improving the internal control system of commercial banks can to some extent reduce various market operational risks of commercial banks<sup>[3]</sup>. This is mainly because the implementation of relevant internal control management measures by commercial banks can greatly improve the level of internal supervision and management, directly improving the quality of accounting information, ensuring the accuracy of accounting audits, and also enabling more accurate and comprehensive disclosure of accounting information, thereby eliminating or improving the current situation of information asymmetry in the market, which is more conducive to scientific business decision-making by commercial banks. Therefore, it greatly reduces the market operational risks of commercial banks.

#### ***3.2. Accelerate the improvement of the internal control system of banks***

The internal control system based on risk management is highly professional. Commercial banks can accelerate the overall optimization and improvement of the internal control system of commercial banks by implementing effective internal control and management against various financial operational risk. On the contrary, a sound internal control system of banks can provide necessary assistance for risk management. In the process of implementing internal control, commercial banks should standardize various business behaviors and authorization behaviors of commercial banks according to the basic principles of risk management and specific operational risk, which is not only conducive to building an efficient internal control mechanism, but also can further strengthen risk prediction and supervision.

#### ***3.3. Enhancing the Comprehensive Competitiveness of Commercial Banks***

The collaborative promotion of risk management and internal control work can greatly reduce the operational risks of commercial banks, ensure their stable operation, and enable them to be in a profitable state for a long time. In this context, commercial banks can issue more credible and reliable financial statements, which is also more conducive to demonstrating their comprehensive strength and competitiveness. By implementing relevant internal control measures, commercial banks can effectively prevent various risk issues in the banking operation process, especially after the subprime mortgage crisis, China's financial industry still adheres to the policy of openness<sup>[4]</sup>. At the same time, by strengthening risk management to enhance prevention awareness, firmly grasp the internal connection between risk control and internal control, and on the basis of comprehensively deepening reform, by improving internal control mechanisms to achieve risk minimization and benefit maximization, to ensure the steady improvement of one's comprehensive strength and competitiveness.

### **4. Current Situation and Problems of Internal Control in Rural Commercial Banks**

#### ***4.1. Current Situation of Internal Control***

The development of commercial banks in China started relatively late, and with the reform and opening up, the internal control system of commercial banks gradually developed. In recent years, with the introduction of more and more internal control regulations, the China Banking Regulatory Commission has increasingly improved its requirements for transparency and systematization of bank internal control construction, and commercial banks have attached great importance to the construction of internal control systems. Specifically, the first is to strengthen corporate governance, improve the company's articles of association, and establish a modern enterprise management structure. The second is to learn advanced foreign theories, promote the reform of risk management systems, optimize

banking institutions, learn from flat management models, and improve the separation of responsibilities and constraint mechanisms. The third is to promote and cultivate corporate culture, establish employees' internal control concepts, and strengthen employees' awareness of risks in various positions<sup>[5]</sup>. The fourth is to strengthen the identification, evaluation, and constraint of risks by banks through strict authorization of credit limits, clear risk limits, and adjustment of investment portfolios. The fifth is to establish a "hierarchical management, limited authorization" system, standardize the business activities of branches, implement comprehensive credit, and strengthen the management of asset liability ratio.

#### **4.2. Existing problems**

##### **4.2.1. Incomplete credit rating system**

China's commercial banks are already in a period of rapid development, but their credit rating systems are still in their early stages, making it difficult to meet international management standards. Due to the late start of credit rating systems, it is inevitable to learn from advanced foreign systems for development. However, foreign experience often does not fully align with China's actual situation, cannot match with China's financial market, and cannot fully leverage the true advantages of the credit rating system<sup>[6]</sup>. In addition, the qualitative and quantitative standards are not reasonable enough, and there is still much room for effort compared to Western "modeling" structures.

##### **4.2.2. Backward internal control system**

On the one hand, the internal control system is not perfect. There is a window area in the business management of branches of commercial banks in China. For example, the performance evaluation system of banks has flaws, blindly pursuing performance while neglecting supervision and inspection of operational compliance, resulting in a negative atmosphere of blindly pursuing performance. On the other hand, the implementation of internal control systems is not effective. Commercial banks face fierce competition and focus on business expansion and efficiency output, often neglecting the implementation of internal regulations. Although many illegal operations are explicitly prohibited, they are unobstructed in many branch offices.

##### **4.2.3. Low efficiency of internal information transmission**

Although the information dissemination in today's society is very fast, China's commercial banks have a huge structure, no flexible information dissemination system, lack of rapid transmission of information among various departments, and cannot effectively and timely share information among various departments, which cannot become a real whole, seriously hindering the risk resistance of commercial banks, while increasing the possibility of operational risk.

##### **4.2.4. Inadequate internal regulatory system**

The internal audit system of commercial banks is a system for supervising and evaluating the bank's business processes and internal controls. However, the internal audit work of commercial banks in China still needs to be strengthened. On the one hand, the internal audit department lacks independence and authority<sup>[7]</sup>. Due to the fact that appointment, dismissal, and salary are all managed by the provincial bank, the internal audit institution only follows the leadership of its own branch, making it difficult to ensure the independence of internal audit and work. Moreover, the problems discovered in internal audit work often only suggest rectification, lacking authority; On the other hand, the internal audit mechanism has a single coverage, limited scope of influence, long audit intervals, lack of continuity, and a lack of high-quality auditors, making it difficult to identify deep-seated problems.

## **5. Internal Control Measures for Rural Commercial Banks Based on Risk Management**

### **5.1. Strengthening the credit rating system**

In addition, for commercial banks, making good use of customer information resources and conducting comprehensive credit rating evaluation work is the key to promoting their sustainable and healthy development. Commercial banks need to change their traditional evaluation methods and use modeling and quantitative evaluation methods to classify customer credit ratings, in order to eliminate credit loopholes as much as possible. Commercial banks can establish specialized internal rating systems for reviewing and verifying credit ratings, and establish standardized evaluation processes to attract more customers through the good application of credit rating systems. They can also expand

their credit business scope according to the actual needs of different customers, reduce non-performing loan rates, and effectively promote the healthy development of commercial banks. One is to establish an independent rating department, which is independent of the decision-making and credit departments, to ensure the authenticity and effectiveness of credit evaluation results. The second is to establish relevant supervision departments to regularly supervise the work of the rating department and form constraints. Commercial banks can establish specialized internal rating systems for reviewing and verifying credit ratings, and establish standardized evaluation processes to attract more customers through the good application of credit rating systems. They can also expand their credit business scope according to the actual needs of different customers, reduce non-performing loan rates, and effectively promote the healthy development of commercial banks. The third is to improve qualitative standards based on the actual situation of each bank, and adopt different qualitative evaluation standards for different businesses and customers, in order to adapt to the development of various commercial banks.

### ***5.2. Strengthening the Construction of Internal Control System***

Having a sound internal control system can prevent potential risks that may arise during the operation of commercial banks. The construction and implementation of internal control systems can be improved in the following aspects: firstly, setting multi-level warning points, distinguishing weight levels for different risks faced by different businesses, and taking corresponding protective measures based on different levels of control warning points. Secondly, strengthen the business operation system, strengthen pre inspection of the business, and prioritize risk prevention. Thirdly, establish a scientific and reasonable decision-making system<sup>[8]</sup>. The decision-making mechanism is the fundamental guarantee for the comprehensive implementation of business direction, measures, and goals. A strict and clear decision-making mechanism must be established, and all major events must be executed according to regulations. Fourthly, commercial banks must be able to accurately identify various potential risk issues in their operations in order to effectively control internal risks. Firstly, commercial banks need to deeply analyze various risk points and develop targeted risk prevention plans based on different market demands and business categories, in order to achieve more flexible internal control and management. Secondly, commercial banks need to establish a comprehensive risk prevention and control system, including risk assessment mechanisms, activity and business control mechanisms, environmental impact and evaluation mechanisms, self-supervision and reporting mechanisms, information transmission mechanisms, and many other mechanisms, to improve the framework of internal risk control and effectively implement risk management.

### ***5.3. Improving Risk Internal Control Mechanism***

Commercial banks should establish and improve the responsibility mechanism for risk internal control, clearly authorize relevant personnel, ensure equal rights and obligations, and follow the principle of separation of powers to ensure mutual restraint among various positions. For example, separating accounts from finance, separating internal control execution and internal control supervision, can better ensure the effectiveness of internal control management. Secondly, under the current decentralization and authorization mechanism, commercial banks need to adopt a more flexible internal risk control approach in terms of specific implementation. One is to further narrow the scope of management, continuously improve management efficiency, and establish a flat organizational structure. Once risk issues are identified, management personnel can receive timely feedback and respond quickly, which is conducive to further enhancing the market responsiveness and decision-making power of commercial banks. The second is to enhance the operability of various businesses on the basis of flat management, and achieve the unity of powers through businesses while clarifying the responsibilities and authorities of all parties, thereby effectively exerting the binding role of the mechanism itself.

### ***5.4. Establish safe and efficient information communication channels***

With the popularization of information technology, commercial banks should also establish efficient information communication channels. Firstly, the information management system should be incorporated into the overall planning, and a data center should be established as a direct subsidiary of the head office to classify and integrate information. Secondly, standardize the format and transmission process of commercial bank information to ensure accurate, truthful, and timely transmission and processing of information between various institutions, both fast and secure. Finally, through training or competitions, improve employees' office automation capabilities and improve the efficiency of information transmission.

### 5.5. Improving the internal supervision and inspection mechanism

The most important internal supervision and inspection mechanism is the internal audit mechanism, and a mature internal audit system can reflect the construction of internal control mechanisms to the management. Auditors need to possess corresponding qualifications to be competent in their work, and in addition, they should have the authority to obtain relevant bank management information. When h, the internal audit department needs to determine the audit coverage of each institution and regularly inspect and evaluate the integrity and effectiveness of the internal control mechanism. Auditors should submit audit reports in a timely manner, and senior management should attach importance to the reports, promptly rectify the identified issues, emphasize audit independence from the source, and ensure authority.

## 6. Conclusion

In short, the banking industry plays an important financing intermediary role in the development of the national economy, and is closely related to the stability of people's lives. The special nature of high-risk and high debt commercial banks determines that they need to face significant operational risks. With the reform of China's commercial banks' shareholding system and the trend of economic globalization, the corporate governance structure and internal control system of commercial banks in China will face stricter tests. In the process of comprehensively deepening reform, rural commercial banks need to build a comprehensive, multi-level, and three-dimensional internal control system based on risk management, improve internal risk control mechanisms, improve internal risk management levels, and resolve safety risks in commercial bank operations with high quality, striving for the steady development of commercial banks.

## References

- [1] Geng J, Hu Y. *Quantitative risk correction method of storage tank based on safety measures*[J]. *Journal of Physics Conference Series*, 2021, 1827(1):012088.
- [2] Zhao P, Wang J, Yan X, et al. *AC Voltage Withstand Test Method and Risk Suppression Measures of Energized GIS Based on Phase-Frequency Control*[J]. *IEEE Transactions on Power Delivery*, 2021, 3(9):15-19.
- [3] Hu Y, Su J. *Research on Credit Risk Evaluation of Commercial Banks Based on Artificial Neural Network Model - ScienceDirect*[J]. *Procedia Computer Science*, 2022, 4(3):58-62.
- [4] Trung N K Q. *The relationship between internal control and credit risk – The case of commercial banks in Vietnam* [J]. *Cogent Business & Management*, 2021, 8(1):1908760.
- [5] Wiredu J, Yu B, Qian Y, et al. *Customer Satisfaction on the Impact of I.C.T Based Products on Rural Banks: A Case Study of Anyinam-Rural Bank Limited in Ghana* [J]. *Journal of Business and Management Sciences*, 2021, 9(4):192-204.
- [6] Liu Y. *Construction of Rural Financial Organization Spatial Structure and Service Management Model Based on Deep Convolutional Neural Network* [J]. *Computational Intelligence and Neuroscience*, 2021(12):1-10.
- [7] Feng S, Lei H, Wan Y, et al. *Influencing factors and control measures of excavation on adjacent bridge foundation based on analytic hierarchy process and finite element method*[J]. *Frontiers of Structural and Civil Engineering: English Version*, 2021, 15(2):17.
- [8] Hahn M, Li S C. *Estimation Of Falls Risk Using A Neural Network Model Based On Measures Of Gait And Balance Control* [J]. 2022, 5(7):42-48.