

Research on Audit Failure of *ST Xinyi

Yuchen Ouyang

Nanjing Audit University, Nanjing, 211815 Jiangsu, China

beth567@163.com

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Abstract: The occurrence of financial fraud audit failures of listed companies affects the benign operation of the capital market, and also creates a reputation crisis for the accounting firm industry. This paper takes the forced delisting stock *ST Xinyi in the A-share market as a case, analyzes the reasons for its audit failure from three aspects: listed companies, accounting firms, and the external environment, and specifically proposes to prevent audit failures caused by financial fraud countermeasure suggestions.

1. Introduction

In recent years, in order to maximize the attention of investors and avoid delisting, some listed companies have resorted to financial fraud to beautify their financial statements and cover up their true profitability. Financial fraud will lead to audit failures. Frequent occurrence of this phenomenon will seriously damage investors' trust in the market environment, undermine the order of the capital market and the interests of the public, and increase audit risks. Therefore, it is necessary to ensure the authenticity of listed companies' accounting information and prevent audit failures. This paper takes *ST Xinyi's financial fraud leading to audit failure as a case, analyzes its financial fraud means, explores the reasons, and puts forward countermeasures to reduce audit risk and prevent audit failure.

2. *ST Xinyi Financial Fraud Audit Failure Case

2.1. Introduction of *ST Xinyi

*ST Xinyi's full name is Xinjiang Yilu Wanyuan Industrial Investment Holding Co., Ltd., which was established in 1998. The original main business was the production and sales of various ceramics. In 1999, the company was listed on the SSE. However, during the 23-year listing process, the company changed its name and owner several times, and its operating performance was dismal. In June 2015, the company went through a series of changes such as bankruptcy and reorganization, and finally moved to Xinjiang. The name of the main body of the company was changed from *ST Guochuang to *ST Xinyi.

2.2. Introduction of Tangtang Firm

Tangtang Firm's full name is Shenzhen Tangtang Accounting Firm, which was founded in 2005. It is a small and medium-sized accounting firm with no experience in securities service business in the past. Tangtang Firm is the annual review agency of *ST Xinyi and its subsidiary Kashi Hanzhenyuan Investment Co., Ltd. (hereinafter referred to as Hanzhenyuan) in 2018 and 2019. It issued a qualified opinion on *ST Xinyi's statements and a standard opinion on Han Zhenyuan's statements. The audit fees totaled 1.99 million yuan.

2.3. Process of the Financial Fraud

In order to cover up dismal operating performance and prevent forced delisting, *ST Xinyi continued to make frauds in 2018 and 2019. The CSRC's decisions on administrative punishment show that *ST Xinyi has false records and major omissions, The details are as follows:

2.3.1. False Records

There are false records in *ST Xinyi's financial reports. In 2018, the amount of falsely increased operating income and profit was 13.39 million and 1.29 million, and the falsely increased amount accounted for 100% and 5.24% of the disclosed amount. In 2019, the falsely increased operating income was 5.72 million, non-operating income was 75.90 million yuan, and the total profit was 79.25 million, accounting for 55.13% and 253.78% of the disclosed amount. After retrospective adjustment, the company's operating income has been less than 10 million for two consecutive years, and it was actually a loss in 2019.

2.3.1.1. Falsely Increasing Factoring Business Income

In 2019, *ST Xinyi entrusted its subsidiary Shenzhen Yangyun Technology Co., Ltd. and Shenzhen Defu Factoring Co., Ltd. to sign an unauthentic factoring contract, inflating its non-operating income by 75.9 million.

2.3.1.2. Falsely Increasing Trade Income

In 2018, Yiyuan Huijin, a subsidiary of *ST Xinyi, signed sales contracts and procurement contracts without commercial substance with Ashin Trading Company and Sibe Investment Company respectively, which inflated operating income and operating costs, which eventually led to profits inflated by 1.29 million.

2.3.1.3. Falsely Increasing Property Fee Income

In 2019, *ST Xinyi's subsidiary and Second-tier subsidiary company signed a false entrustment contract to provide property management services for Kashi Kaiyuan Market and were responsible for collecting property fees and other fees. In fact, the company did not obtain property management rights at that time. This behavior made the profit was falsely increased by 2.30 million in 2019.

2.3.1.4. Falsely Increasing Rental Income

During the audit period in 2020, *ST Xinyi and its subsidiary Han Zhenyuan signed a rent offset agreement with Xinjiang Hongsheng Real Estate Company. There was no actual lease or sublease, the content of the agreement was not actually implemented, and the offset of the debts of both parties was false. This resulted in an inflated profit increase of 1.3 million in 2019.

2.3.2. Major Omissions

*ST Xinyi did not disclose that in the "Kashgar City Kaiyuan Market Land Planning Adjustment and Development Agreement" signed by the subsidiary and the Kashgar Natural Resources Bureau, "If the demolition is not completed before August 24, it will be deemed that Han Zhenyuan has given up the development, and the Kashgar Natural Resources Bureau will take it back." There are major omissions in risk matters.

2.4. Punishment Results

According to the CSRC penalty decisions, the CSRC issued a warning and a fine of 8 million to *ST Xinyi, a warning and a fine of 12 million to its chairman and actual controller Huang Wei, a warning and a fine of 3 million to the supervisor and the legal representative of the subsidiary. Li Yong, and both of them were banned from entering the securities market for life.

For the Tangtang Firm, the CSRC required it confiscate the business income and impose a fine of 11.82 million, and suspend from engaging in securities services business for one year, and imposed fines and securities market debarment measures on the three CPAs concerned.

3. Analysis of the Reasons for the Audit Failure of *ST Xinyi

3.1. Listed Companies

3.1.1. Delisting Pressure

*ST Xinyi's main business continuity is not strong. According to the 2020 annual report, affected by the bankruptcy and reorganization in 2015, the main business has not yet fully recovered in 2020. From December 2021 to March 2020, the company issued dozens of delisting warnings. Due to the company's poor sustainable operation ability and strict delisting system, it has brought great pressure to the top management, which prompted the company to conduct financial fraud by adjusting income and other means in 2018 and 2019.

According to the CSRC's investigation and trial results, the real operating income from 2018 to 2020 was 0, 4.66 million and 3.46 million respectively after retroactive adjustment. The SSE has made a decision to terminate the listing.

3.1.2. Failure of Internal Controls

According to the announcement disclosed,*ST Xinyi has not disclosed audit reports on the company's internal control since 2014, nor has it disclosed self-assessment reports on internal control. The public cannot obtain effective information on its internal control. Not only that, *ST Xinyi did not have a full-time financial officer and board secretary. There may be violations of laws and regulations in information disclosure. From the above matters, it can be seen that there are major defects in the company's internal control environment and control activities.

3.2. Accounting Firm

Tangtang Firm and relevant auditors did not strictly follow the auditing standards, and had major negligence, which resulted in the failure of the audit.

3.2.1. Lack of Audit Independence

In March 2020, *ST Xinyi was introduced by the intermediary Liu Yaohui to hire Tangtang Firm as its audit firm. According to the CSRC administrative punishment decision, Tangtang Firm and *ST Xinyi have formally signed agreements before the audit. In the agreements, Tangtang Firm expressly undertook not to issue an audit report with an “adverse opinion” or “negative opinion” on the financial statements, indicating the fact that *ST Xinyi purchased the audit opinion. At the same time, the two parties also agreed that if Tangtang Firm and the signing accountants are punished by the regulatory authorities, *ST Xinyi will fully compensate for the losses, including fines and reputation loss of 500,000. Therefore, Tangtang Firm changed the audit opinion in violation of regulations and deleted important content in the audit reports.

3.2.2. Serious Deficiencies in Revenue Audits

There are serious deficiencies in the auditing procedures, which failed to implement sufficient and necessary audit procedures. After the team discovered that *ST Xinyi's rental income only had an abnormal situation in which the invoice did not provide the relevant contract, it assisted the company to revise the rent offset agreement and informed it to cover up the abnormal situation as soon as possible, so that Han Zhenyuan's rental income of 1.3 million confirmed. In the face of major abnormalities in trade income, property fee income, and fee income, accountants revised the audit papers. To sum up, Tangtang Firm and the signing accountants did not implement sufficient audit procedures to verify the authenticity of the business, but expressed their approval and confirmation in the report. They continued to perform additional audit procedures after the audit report date. They even adjusted and deleted the audit draft in order to cover up the problem adjustment.

3.2.3. Deficiencies in the Confirmation Procedure

Tangtang Firm did not maintain control over the confirmation of accounts receivable and accounts payable. It contacted the object of the confirmation not directly but through *ST Xinyi. It made the letter confirmation procedure paper-based. The execution of the correspondence procedures on other receivables and non-operating income was inappropriate, and it did not confirm the identity of the letter confirmation recipients, nor did it pay attention to the intermediaries.

3.2.4. Deficiencies in Investment Property Audits

When Tangtang Firm audited *ST Xinyi investment real estate, it used the evaluation results of the evaluation agency but did not consider the rationality of the important assumptions of its report conclusions. The number of rents was too small and not comparable with the local real estate market, which made it unable to issue an appropriate audit opinion.

3.3. External Environment

Since the establishment of the stock delisting mechanism, the number of delisted companies has not been large. The disclosed financial statements *ST Xinyi since 2007 have shown a phenomenon of 2 years of losses and 1 year of profits. Although the company's sustainable operation ability is relatively poor, its listing status has not been affected basically, leaving *ST Xinyi executives with a lucky break.

March 2020, the new securities law has been implemented. The qualification examination and approval system will be changed to the filing system. However, most small and medium-sized firms are unknown and lack competitive advantages. The few listed companies that have not hired audit firms have become a bridge for these firms to enter. However, these companies actually have more or less audit problems^[1]. Tangtang Firm was the first small and medium-sized firm to undertake the annual report of A-share listed company.

4. Countermeasures and Suggestions to Prevent Audit Failure

4.1. Improving the Internal Supervision of the Superior Company

*ST Xinyi rarely discloses internal control information in recent years, and the public cannot obtain effective internal control information. A sound internal control system can reduce or even avoid the risks that the company may face^[2]. Therefore, senior management needs to strengthen internal control, adhere to the principle of separation of incompatible duties, and set up an independent internal audit agency to actively find loopholes and eliminate hidden dangers. The board of supervisors of the enterprise should strengthen supervision and management, form a good supervision mechanism, and eliminate the phenomenon of management fraud from the root cause.

4.2. Strengthening the Management of Audit Entities

CPAs should have professional competence and maintain audit independence when undertaking audit services. On the one hand, independence is a prerequisite for auditing. CPAs should abide by professional ethics, adhere to professional ethics, and avoid violating professional ethics. On the other hand, CPAs should strictly abide by auditing standards, strengthen the application of modern risk-oriented auditing, design and implement more scientific, reasonable and effective auditing procedures.

Accounting firms should do a good job of quality control and strictly control quality, mainly in the maintenance of independence, business quality reviews, etc. They should jointly supervise the legal compliance of the CPA profession in the firm.

4.3. Strengthening the Dynamic Supervision

In recent years, the two forces of regulation and anti-regulation, fraud and anti-fraud, between listed companies and regulatory agencies, have continued to compete in the capital market^[3]. The new "Securities Law" cancels the threshold for accounting firms to practice, and changes from the approval system to the filing system, so that all accounting firms can undertake securities and futures service business, which will undoubtedly increase the difficulty of supervision. The CRCS emphasizes improving the supervision and coordination mechanism, forming a joint supervision force, strictly supervising listed companies and accounting firms, and using big data analysis and other means to accurately crack down on financial fraud and standardizing the order of the industry.

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