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Brief Analysis on the Causes of Audit Risk of Listed Companies

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***Abstract*—Recently, financial fraud of listed companies has triggered the re-evaluation of audit risks of them at home and abroad. Audit risks of those companies mainly form the subjects related to the generation of audit service chain and interest groups, including listed companies themselves, regulators, policy-making departments, stakeholders and accounting firms. It is helpful for public and interest groups to analyze the causes of relevant audit risks rationally, to effectively avoid them.**

***Keywords*—listed companies; certified public accountants; audit risks**

I. INTRODUCTION

Carillion, the 200-year-old British construction giant, declared bankruptcy at the start of 2018. KPMG, however, stated in its last annual report, that Carillion had "at least three more years to live". Just three months after the report was issued, the company went bankrupt. But this financial scandal is just the tip of the iceberg of the audit scandal of listed companies. In recent years, some domestic and foreign listed companies have experienced financial problems. Fraud scandals directly lead to the inefficiency of accounting reports as well as the bankruptcy of the listed companies. Investors and employees are harmed and public is in the condemnation of fraud, and the fake accounting reports. Domestic and foreign certified accountants have been stuck in protracted legal battles owing to continuous cases of fraud. Therefore what are the causes of these audit risks and what kind of audit risk that the listed company faces is of increasing significance? To guard against audit risks has become the focus of attention, for certified public accountant industry and even the public. We believe what subjects effluent the financial statement are related to generating financial information chains, including listed companies, policy-making departments, regulatory agencies, close benefit groups and accountant firm. And they are also the major factors of audit risks of accounting firms.

II. THE ANALYSIS OF THE SUBJECTS AND STAKEHOLDERS RELATED TO THE AUDIT SERVICE CHAIN

A. Listed Companies

As the main body of securities market, listed companies should prepare the accounting statements according to the accounting standards and regulations issued by the administration. They ought to be responsible for the authenticity and integrity of accounting information and make certain that the statements must be audited by certified public accounting firms, both before and after the listing. It is very important that certified public accountants audit the financial statements. It represents the interests of shareholders and creditors and may become a ideal bridge between the executive directors of listed companies and the users of the statements.

But the “false financial information” and “financial frauds”, exposed recently in some big companies constitute the major audit risk of accounting firms. Several resources have been suggested from the perspective of listed companies: corporate governance structure, abnormal pressure accepted by the directors, weak internal control, and poor quality of management and so on.

At present, the problems of governance structure speak in the board of directors manipulated by major shareholders, independent non-executive directors who fail to perform their duties, too complex organization and the involvement of special corporate bodies or management authority.

The abnormal pressure on the management mainly includes the unreasonable expectations from public, the demand of external financing, the rid of special treatment or taking it public again and the requirements of debt constraint clauses.

The weakness of departmental control is mainly of the form that the management controls over the internal control system.

The internal audit colludes with each other, making the internal control invalid. The internal control system is unreasonably designed or invalidly executed, failing to perform the duty.

Management quality problems are mainly found in the company in form that the director, manager or other key employee have violated securities laws or other regulations or have been sued for alleged fraud or breach of regulations. They may take crucial statement improperly and are try to legalize it, not to correct major defects of internal control in time. The audit fees paid by listed companies also affect quality of audit violently. However, the quality of accountant and the collusion of the internal and external audit are not found as the main causes of the risks.

The following factors should be taken into account when the accounting firms charge for service fairly: the first one is the knowledge and skills required by auditing services. The second is the level and experience of the auditor is required. The third is how much time should be spent by each auditor for this service. The fourth is the responsibilities for providing audit services. However, in the audit market of listed companies, owing to the violent low-price competition, the independence of accounting firms has became weaker as well as the audit quality been reduced rapidly. The reason is that the inner demand of high quality accounting information has not formed in some listed companies. Thus, those companies hardly consider the audit quality more seriously than the audit fees. When they choose an accounting firm, the price of an accounting firm is often considered rather than the reputation and practice quality.

B. Regulators

To maintain the securities market order, the regulatory authorities shall supervise and assist the listed companies to comply with the legislation and regulations. Standards should be implemented legitimately in the long run.

Since China's securities market, as an emerging industry market in this nation, there are inevitably many gaps and loopholes in it, although regulators have made great contributions to the issuance and trading of securities and protection of the legitimate rights and interests of investors, in order to maintain social and economic environment as well as public interests.

To be specific, it is mainly reflected in the following two aspects: first, in the process of supervision of listed companies, there is a wide range of penalties for individual listed companies that breach the rules due to the constraints of various factors. Second, penalties are not strong enough to deter future breakers owing to the unpublished violation facts and punishment decisions although a large number of violations are investigated and dealt with every year. The reason for the punishment is not sufficient or clear as it is difficult to distinguish accounting responsibility and auditing responsibility for the reason of "not being diligent and responsible".

In addition, the lack of supervision not only exists in the companies, but also exists in the certified accounting firms. A prevailing view in accounting is that the supervision of the CPA industry is not strict, which reflects an unsatisfied feeling of the current quality of audit firm. The penalties for vicious competition and selling audit opinions in the industry are not violent enough. And the emphasis of punishment for the signed certified accountants and the overlook of others can turn the penalty to a more or less nominal one. The sense of responsibility and risk awareness can scarcely be enhanced, which makes it impossible to fundamentally solve the problem of high audit risks.

C. Policy-making Departments

The policies directly related to the financial information of listed companies include accounting standard, auditing standard and information disclosure standard. Accounting standards are the basis for the preparation of accounting statements by listed companies. Auditing standards are the basis for certified public accountants to audit the accounting statements of listed companies. And the information disclosure standards are the basis for the preparation of information disclosure content of listed companies. The above mentioned standards act as unity in the administration, which constitutes an important legal basis for listed companies to prepare their financial information. Therefore, whether the policies formulated by the policy-making department are open and transparent, clearly organized and easy to operate directly affects the financial information quality of the listed company and also determines the audit risk of the accounting firm.

However, above three standards have not been combined well, which means there are still lack, incompatibility and conflict. Different policy-formulating department set the regulations within the scope of their respective responsibilities. The lack of timely and effective communication and coordination between these departments result in the lack of cohesion between certain norms and necessary supporting measures. These loopholes are the cause of the facts that certified public accountants in the audit process always find it confused about what to do.

Auditing standards are not operational can be a serious problem. If the independent auditing standard, as an important basis for certified public accountants to carry out auditing business, is of infeasibility and abstract, the application of certified public accountants will be more difficult.

The absence of requirements and lack of clearness in the standards for information disclosure will increase the audit risk of certified public accountants. In another word, the transparency and fair of an enforcement of specific regulations are of much significance. Accounting standards and accounting system are the direct basis for listed companies to conduct and prepare accounting statements. It will increase the difficulty for certified public accountants to make judgment if there is no clear regulation in any aspects.

In addition, the disclosure time of annual report are also important factors affecting audit quality. The disclosure time is decided by the accounting annual time, which is formulated uniformly by the regulators, which results in the concentrated audit time and the insufficiency time for each client. However, only when the audit time is sufficient and the arrangement is reasonable can the accounting firm guarantee the full implementation of the audit procedure.

According to the accounting law, all Chinese enterprises, including listed companies, must take the Gregorian calendar year as the unified fiscal year and the compilation and submission of annual financial reports must be completed within four months after the end of the year. Moreover, the disclosure of annual reports by listed companies is after the appointment with the Exchange, which further shortens the auditing time of accounting firms.

What else is the large company size. Some listed companies belonging to the group company. In this case, the group headquarters, the parent company, division, branch,

subsidiary, joint ventures and associated enterprises are all need to be brought into the system of financial accounting statements and be reported to the whole formally.

To achieve this, passing through amalgamation, legally inspection and summary is a must. Not only does the direct audit section take up quite a time, but also the determination of appropriateness of other work of other parts of the giant business group. Therefore, completing the audit work in a relatively short time with high quality requires accounting firms must be equipped with fairly sufficient audit resources but quite accounting firms have difficulties in making it.

D. Related Interests

The concept related interests here refers mainly to local administrations and governments. Administrative intervention of local authorities has become an important risk resource of listed companies. The local governments or departments meet their different purposes and needs through the administrative interference on the listed companies in the form of distortion of financial status and operating results. At present, some may use their power to force accounting firms issue unqualified reports to meet the target performance measures. In addition, certified public accountants also bear the pressure from investment banks, investors, creditors and other aspects of stakeholders.

E. A Public Accounting Firm

1) Professional ethics: The professional ethics requires certified public accountants to be of independence of mind and independence in appearance. When conducting audit service, the auditors shall not let anything to affect their true and fair view. Some certified public accountants lose their independence because of economic interests.

a) Self-interest threat: Self-interest threat refers that there is an interest correlation between the auditor and the company, especially the economic one. The form of interest correlation can be varied.

For example, when auditors are one of the shareholders of the audited company, the self-interest situation happens. The auditor is likely to avoid issuing a qualified report or adverse report deliberately, because these kinds of appraisal would cause depreciation and harm their own interest. Other possibility is that the company threatens the accounting firm with reduced payment or future employment, if the issued reports are not satisfied enough. The fact situation that one of the families of the auditor is working as an employee or a director in the company is also possible. In addition, another well-understood example is the gifts. Accepting gifts given by the clients, especially expensive ones can be regarded as a kind of damage of independence.

b) Self-review threat: This refers the situation that the auditors exam the results of their own work.

For example, the company outsources the internal control service to the accounting team which also audits their financial statement. If an accounting firm has offered internal audit, risk assurance, tax service or consulting service to a company, it is improper to provide audit and assurance for it at the same time; or it can be accepted that these services are handled by totally separated teams to avoid the threats.

c) Advocacy threat: It happens when an accounting firm represents a customer. One of the most typical situation is defending or testifying on be half of the clients.

d) Familiarity threat: It is from over-cooperation between the auditor and company. Cooperation causes personal familiarity, which provided chances for fraud to some extent.

e) Intimidation threat: This is threat from intimidation. One of the common examples is that the client threatens the audit firm to sue the firm, if the auditors do not comply with the client. In this case, the firm may face a lot of pressure, including the possibility of reputation damage or economic loss. As the result of these concerns, the auditors may choose to meet the company's demands that produce an unqualified report the company wants.

2) Quality control: Quality control is the policy and procedure designed and applied by accounting firms to ensure that the quality of reports meets the auditing standards. Problems in quality control will directly affect the quality and cause risks.

Tertiary review system refers to a system where the report and working paper should be examined by managers and partners. In accordance with the provisions of the quality control guidelines, the firm should establish a hierarchical supervision system to clarify the scope of duties of the review personnel at all levels. However, in the actual implementation, it often becomes a mere formality and hardly receives the prospective result due to various reasons.

The management plays a leading role in the quality control of the accounting firm. If the management of the firm pays insufficient attention to quality control, the firm will suffer quality risks owing to the lack of written or effective quality control policies and procedures. It may result in, for example, that the review personnel do not perform their duties seriously or are not professionally competent enough. Examiners are lacking in awareness of the significance of their own work, and fail to fulfill the prescribed duties seriously, and the review becomes a formality.

In conclusion, the attention to quality control directly affects the attitude of general auditors in quality control and then the quality of the whole audit work.

3) Market competition: The competition is extremely fierce owing to the limited market.

Generally speaking, competing for customers through low prices or catering to customers by issuing an unqualified report are two main common methods. However, both the two may lead to a considerable decline in audit quality. Some certified public accountants with low professional ethics reduce audit quality to pursue economic interests. These audit firms use a "clean" audit reports as bait to attract customers and meet unreasonable demands of customers, which is one of the main reasons causing the server competition. In conclusion, with some accounting firms keeping competing with each other, listed companies can

freely choose their satisfied firm. It is leading to vicious competition.

4) Professional competence: Professional competence not only requires certified public accountants to have professional knowledge, skills and experience, but also to be able to complete the task entrusted by customers economically and efficiently. Therefore, the lack of professional competence can be usually the source of audit risk. Lacking of audit experience and audit experience in similar industries can be risks. Auditors need rich relevant audit experience to enhance their professional judgment due to the complexity of the business of listed companies which is of particularity in different industries. Limited audit experience makes it impossible for certified public accountants to draw lessons from the previous work in order to identify key areas and potential risk. In this case, auditors cannot make correct judgment on major accounting issues, thus generating audit risks.

The lack of familiarity with relevant laws and regulations is an important reason for the audit risk of listed companies. Relevant laws and regulations are an important basis for certified public accountants to make judgment on whether the company's accounting information and business activities are legal or not. If the laws and regulations with frequent changes are not understood or grasped accurately, it is possible to make wrong judgment, form wrong conclusions and generate audit risks.

The poor ability to use knowledge flexibly is another cause. While it is important to learn knowledge, the ability to use it flexibly is even more important to a professional. Copying is not conducive to rapid judgment based on specific situations and to identify abnormal situations. This is difficult to find the company's hidden risks and problems.

However, the presumption that the auditors do not qualify relative auditing service is actually not a main reason. It can be seen that the qualification is not the most important factor in the competency of the auditors, which is consistent with the fact that many people attach importance to the acquired auditing experience.

III. Conclusion and Suggestion

Through the above analysis, we can conclude that the causes of audit risks of listed companies are mainly related to the subjects related to generating financial information, including listed companies, regulators, policy-making departments, stakeholders and accounting firms.

- Some listed companies compile false financial information and even conduct fraud, which constitutes the main audit risk of certified public accountants. The main reasons leading to the audit risk of certified public accountants include the problems of corporate governance structure, abnormal pressure on the management authority, weak internal control system and the poor quality of the management.
- Whether the regulatory measures securities regulator is proper or not and the whether the supervision and punishment are effective or not will be directly related to listed companies' behavior. The degree of the reveling of punishment and its authority is related to default cost of high and low, having increasingly larger influence on the audit risks.
- The accounting standards, auditing standards and information disclosure standards formulated by the policy-making department constitute an important legal basis together for the financial information generation of the listed company. Whether the accounting standards are proper and transparent, well organized and easy to operate or not will directly affect the financial information quality of the listed company and also play an important role in the main cause of audit risk of the accounting firm.

  Stakeholders' administrative intervention imposed in listed companies to meet their different interests and needs has badly distorted the real financial conditions and operating results of listed companies, which has a great impact on the practicing quality of certified public accountants.
- For various reasons, the audit failure of accounting firms has become the focus of public criticism. The audit risks come from professional ethics, quality control, audit methods, competitive environment and professional competence, however, there are also those who are forced to submit to, cheat together and commit the fraud.

In order to avoid and guard against the audit risks of listed companies, what is a must are not only the better external audit environment and audit institutions formulated sound and effective, but also the diligent and responsible auditors earnestly following the audit standards. To ensure the audit quality and reduce the audit risk to an acceptable level, the following factors, which can be divided into external and internal aspects, should be considered to prevent audit risks of listed companies:

A. Improving the External Auditing Environment

This includes the legislation the auditors should obey during they conduct the auditing service and the regulations and laws to guard against the fraud and false within these listed companies.

A set of perfect laws and regulations system is necessary, which is an effective guarantee for the efficient and high-quality audit work. Especially those for certified public accountants, only with a good practice environment with sound and effective auditing standards and regulations can certified public accountants adhere to the principles of independence, objectivity and impartiality in their practice. From the audit scandals in recent years, a large number of accounting firms and their certified accountants have been forced by the audited companies or even some government departments to issue an unqualified auditing report which is against their will.

Building up a strong the construction of internal control system can surely be preference. If the audited unit has a complete and efficient internal control system, timely and standard information disclosure, the difficulty of auditing work can be greatly reduced, thereby reducing the risk of auditing.

Therefore, revising relevant laws and regulations to improve the management structure of listed companies as well as reform the recruitment mechanism of accounting firms is a great step. To achieve this, the legislation should strengthen the construction of shareholder meetings, the board of directors and the board of supervisors. This can be realized by improving the system of independent executive directors and audit committees, formulating strict rules and regulations for the appointment of audit committees to accounting firms, weakening the right of nomination of major shareholders and management to employ accounting firms and improving the independence of accounting firms. Improve law enforcement level and reduce arbitrariness in the process of law enforcement. Strengthen oversight of listed companies, stakeholders, accounting firms and other entities by giving full play to the role of industry organizations, government departments and the public, and helping to establish a supervision system that integrates government supervision, industry self-discipline and press supervision.

B. Improving the Quality of Auditors and Adhering to Standards to Create Conditions for Audit Risk Control Within the Auditing Firms

Auditor is a professional and technical occupation and auditing is a high-level, comprehensive economic supervision work which needs a set of systematic occupational standards guidance, constraints and norms. Therefore, in addition to professional knowledge such as auditing, auditors also need to have a strong sense of responsibility and a high level of professional ethics.

Firms should conduct the auditor training and education on a regular basis and the employees should abide by the code of conduct as well as insist on principles such as seeking truth from facts, objective and fair, integrity. It is necessary to attach significance to constantly updating all kinds of knowledge and improving the ability of analysis, judgment, communication and forecasting economic activities and cultivate a batch of auditors suitable to the audit work and having certain professional skills and ethical level, in order to achieve the purpose of risk control.

C. Establishing a Risk Identification, Valuation and Prevention System

Identification of audit risk: audit risk identification refers to the process of judging, classifying and signing the nature of the potential risks faced by the auditing service. In general, auditors can identify common audit risks with past experience and simple risk knowledge. There are two general approaches to audit risk identification: one is to use external risk information and data to identify risks. For example, according to the cases and information introduced by the press, including professional books, professional newspapers and professional magazines, etc. Then analyze, identify the risks based on the specific situation and screen them by the auditors.

The second is to rely on the strength of accounting firms, according to customer characteristics to identify risks. Auditors must always keep their eyes peeled on the various manifestations of risk and determine the probability of occurrence, in order to minimize the occurrence of risk. In audit risk, inherent risk is uncontrollable and auditors can only give different attention according to the inherent risk of different audit objects. To control risk, auditors during the auditing service, can only evaluate the risk degree and audit according to different degrees to determine control risk. As for the one of smaller risks, auditors usually audit general random objects only in small scope, to control the audit risk within an acceptable range economically.

Audit risk identification answers the question of what risks the audit activity faces and what risk factors exist. The next is, the probability of the occurrence of audit risk is estimated and predicted by using the probabilistic statistical theory and relative experience on the basis of audit risk identification, through the analysis of the previously collected data. Auditors analyze, estimate and test the occurrence of auditing risks of certain audit items and the degree of harm they may cause, in view of many subjective and objective conditions during the audit process, so as to find the reasonable level of audit risk and to try their best to avoid or reduce the potential occurrence of auditing mistakes. One of the important duties of the auditors is to try to control the audit risk under the expected level in specific service according to the requirement of the audit report users, audit time, audit fees and other factors, with an advanced determined acceptable degree of risk and loss.

Audit risk assessment is an auditing evaluation of risks, which is taking the incidence of the audit risk and loss severity into consideration, with the combination of other factors taken together, on the basis of the audit risk identification and estimation. It should find the possibility of auditing risks as well as its harm degree, and compare with accepted standards to determine whether the audit risk is beyond the scope of social acceptance, then to decide whether to need to take control measures and to what extent control measures should be taken.

Pay attention to risk transfer and dispersion to avoid audit risks. The mutual purpose of above actions is that risks should be transferred and dispersed as much as possible, on the basis of identifying, judging and assessing risks. For example, avoiding audit risk through capital accumulation. Accumulation is a positive and very effective financial approach. Generally speaking, what happened in the enterprises of developed countries is investing with its own capital first, then borrowing money from banks or issuing company bonds, and at last, issuing shares. Similarly, as far as the certified public accountants concerned, according to the provisions of the law on certified public accountants in China, accounting firms should establish professional risk funds and handle professional liability insurance. The essential mechanism of avoiding audit risk by relying on

fund accumulation is an economic security system and loss allocation mechanism which compensates a single audit risk when it encounters risk accident by accumulating a certain amount of fund. Therefore, the insurance of certified public accountants practicing liability insurance is also a measure of risk diversification.

D. Paying Attention to the Warning Signals of Audit Risks of Listed Companies

Constructing early warning system and foreseeing is cheaper and easier for accounting firm rather than making up for the mistake. Therefore, how to effectively prevent risk in financial institutions has always been the top concern in the worldwide auditing firms. To some extend, if listed companies appear the following signals, auditors should pay close attention to ensure audit quality and guard against audit risks.

Frequently changing accounting firms may be suggesting problems. When a listed company changes a public accounting firm or a certified public accountant, the latter auditors should attach great importance to the change and find out the true cause of the change seriously. .Pay attention to the abnormal stock changes. Companies whose share prices fluctuate sharply are also at greater risk ahead of the annual or interim reports, as this is often combined with falsification of financial data. Large scale of legal disputes can be the hint. On the one hand, when a listed company is involved in legal disputes, it is very likely to bring liabilities and losses to the company, causing the company to get into financial difficulties and even lose the ability of sustainable operation. On the other hand, the company is often involved in legal disputes, which may cause reputation crisis or the company itself has operational risks.

E. Being Cautious When the Main Cash Flow Is Negative

Because profit is determined according to the accrual system, it is easy to be falsified. Mistakes in it are hard to find but cash flow is determined according to the cash system which is more objective. Thus, we should watch closely when the profit of the company is large, however with a suspicious negative cash flow, especially when the profit of the company's main business and the cash flow of the main business are very different. In this case, the auditors should pay great attention to the reasons and pay attention to the authenticity of the company's income. The auditors should acquire the help of internal control to fully and carefully assess the listed company, to ensure the quality of report and reduce the audit risk to a minimum.

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