

****ST Xinyi Company's Financial Fraud and Audit Failure Case Analysis***

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Abstract: From the perspective of the financial fraud case of "Xinjiang Yilu Wanyuan Industrial Holding Co., Ltd.", this paper investigates the causes of audit failure by analyzing its fraud means. The study found that audit failure is the result of the symbiosis of firm violations and financial reporting fraud of listed companies. There is a correlation between the internal control of accounting firms, the independence of certified public accountants and the internal business strategy characteristics of listed companies and audit failure. The research conclusion provides empirical evidence for modern risk oriented audit and fraud audit standards. In order to effectively prevent audit failure, this paper puts forward corresponding countermeasures and suggestions from the aspects of certified public accountants, audited units, and audit market supervision.

1. Introduction

The Chinese securities market started late, but it is still advancing. Listed companies are major participants in the securities market and play an important role in the development of the securities market [1]. At the same time, every fraud incident of a listed company is a blow to the securities market. Therefore, through the study of the financial fraud case of Xinjiang Yilu Wanyuan Industrial Holdings Co., Ltd. (hereinafter referred to as *ST Xinyi), as well as the analysis of the audit failure of Shenzhen Tangtang Accounting Firm, mainly based on the certified public accountants, accountants Firms, audited units and regulatory authorities. Then the relevant countermeasures are provided for the problem of audit failure.

2. *ST Xinyi Case Introduction

2.1. Introduction of *ST Xinyi Company

The business scope of Xinjiang Yilu Wanyuan Industrial Holdings Co., Ltd. is foreign trade, the right to operate small-scale border trade; medicine and medical equipment; e-commerce, warehousing and logistics services; production, processing and sales of mineral products; Sports, entertainment, tourism, catering, energy, environmental protection, high-tech and other industrial investment and management[2]. Since 1999, after the issuance of 45 million public shares. The company's total share capital is 125 million shares. Its 45 million public shares were listed on the

Shanghai Stock Exchange on September 23, 1999. On June 5, 2015, the company name was changed from "Guizhou Guochuang Energy Holding (Group) Co., Ltd." to "Xinjiang Yilu Wanyuan Industrial Investment Holding Co., Ltd."

2.2. Overview of Tangtang Accounting Firm

Shenzhen Tangtang Accounting Firm was founded by Yutang Wu in December 2004. In 2020, Tangtang ranked 21st among the first batch of registered accounting firms engaged in securities service business issued by the Ministry of Finance and the China Securities Regulatory Commission. Among the A-share listed company accounting firms, it ranks 41st in the country, first among small and medium-sized accounting firms in the country, and Shenzhen local brand accounting firm.

2.3. The Specific Means of *ST Xinyi's Financial Fraud

2.3.1. Inflated Trade Income

Mou He, a friend of the actual controller of *ST, Mr. Huang, the actual controller of ST, the actual controller of Axin Trading, and the major shareholder of Sibe Investments. Yiyuan and these two companies have not obtained actual control over the commodities in the trading business services. Therefore, the risks and benefits associated with these commodities are not assumed. Funds circulate among the three companies, forming a closed loop, but actual funds flow into Yiyuan. The sales contract signed by Yiyuan and Anxin Trading has no commercial substance and does not meet the conditions for revenue recognition. *ST Xinyi acts above. This directly led to an inflated operating income of 13.3854 million yuan in the 2018 financial report, related operating costs of 12.0943 million yuan, and an inflated profit of 1.2911 million yuan, resulting in a financial false report of operating income of 2.1266 million yuan in 2019. According to the report, operating expenses were 2.1445 million yuan and sales expenses. 230,900 yuan, deducting profit of 248,800 yuan.

2.3.2. Inflated Property Fee Income

Dingshengyuan was established on August 30, 2019, and was not eligible to recognize revenue before that. On November 18, 2019, Dingshengyuan began to have the property management rights of the open source market. Before that, he did not have the right to entrust Hongtengda to manage the open source market for him. In 2019, the open source market is actually provided by Hong Tengda with related property services, so the corresponding income and costs should be confirmed by Hong Tengda. As of the issuance date of the 2019 annual audit report, Hongtengda has not allocated the property management fees of the open source market in 2019 to Dingshengyuan, and Dingshengyuan neither actually provides property services nor confirms property costs. Therefore, there is no actual cash inflow, and its confirmed operating income is 229.70 yuan. Not meeting the accounting income recognition conditions, the above behavior of Xinyi resulted in an inflated operating income of 229.70 yuan and an inflated profit of 229.70 yuan in the 2019 annual financial report.

2.3.3. Inflated Rents Offset Income

The Rent Settlement Agreement is an agreement entered into during the 2020 audit and is very different from other lease contracts. Only the area of the leased property is specified, and the specific store number of the floor of the leased property is not specified. Hongsheng Real Estate did not actually lease the property in the open source market, nor did it collect rent or sublease the

related property, and the related debt was not offset. The agreement was not actually fulfilled, and Zhenyuan Han still had the right to rent the property, so it did not meet the income recognition conditions. The above behavior of Xinyi resulted in an inflated operating income of 1.3 million yuan and an inflated profit of 1.3 million yuan in the 2019 financial report.

2.4. Punishment Decision

The China Securities Regulatory Commission issued a penalty decision on February 8, 2022, ordering the company to make corrections, giving a warning, and imposing a fine of 8 million yuan.

3. Tangtang Firm's Analysis of the Reasons for the Failure of *ST Xinyi's Audit

3.1. Reasons for Accounting Firms

3.1.1. Accounting Firms Lack Audit Independence

Although Tangtang Firm knew that Xinyi's annual audit business was rejected by other firms, it still signed an audit agreement with *ST Xinyi, and promised not to express "unable to express opinion" or "negative opinion" in the annual audit report, and It is required that if the firm is punished by the regulatory authorities, *ST Xinyi will pay compensation. Therefore, the audit independence of Tangtang Firm is seriously lacking [3-4].

3.1.2. The Internal Control of Accounting Firms is Seriously out of Balance

Former partners Zhe Li, Jiansheng Chen and Yingjun Deng also made it clear in 2019 that they would not undertake this audit. However, Yutang Wu, the current person in charge, without the public authorization of the legal representative of the firm, made his relative Gaofeng Wu blatantly violate the relevant regulations and stamp the audit business agreement. At present, the firm has withdrawn its official seal [5]. And in the second inquiry letter received on April 27, 2022, it has been replied that the authenticity of the official seal previously affixed is doubtful. Therefore, when Tangtang Office audited *ST Xinyi, its internal control was seriously out of control, and it did not meet the conditions for issuing an audit report.

3.2. The Reasons for the Certified Public Accountant

3.2.1. CPAs Lack Independence

A CPA needs to be very independent. If auditors cannot exist as independent individuals and unite with the audited unit, they will blindly pursue their own interests, issue erroneous audit reports, and eventually lead to audit failure. When issuing the 2019 annual audit report of *ST Xinyi Enterprise, some certified public accountants of Tangtang Accounting Firm believed that there was a problem with *ST Xinyi, which did not meet the audit conditions and refused to sign it, but Tangtang Accounting Firm was a small and medium-sized enterprise and was not willing to give up *ST Xinyi Such a big client, after signing an illegal agreement with *ST Xinyi to promise compensation for the accident, hired another certified public accountant and signed the audit report within three days of his employment. Such conduct is inconsistent with auditing procedures and the professional ethics of a certified public accountant [6-7].

3.2.2. The Professional Ability of Certified Public Accountants is Insufficient

When reviewing the rent credit agreement of *ST Xinyi, it was found that this agreement is very different from other agreements, because this agreement only specifies the area of the leased property, and does not specify the specific information such as floors, shops, etc [8]. The number of the leased property. Hongsheng Real Estate did not actually lease the property in the open source market, nor did it manage or sublease the related property, and the related debts have not yet been offset. According to the audit manuscript, Shenzhen Tangtang Certified Public Accountants did not record the abnormal situation of the contract in the manuscript, indicating that the certified public accountant did not question this obviously illogical situation, and did not take further audit measures to understand the contract.

3.3. Reasons from the Audited Entity

3.3.1. *ST Xinyi Company's Internal Control Failed

In the internal control audit report of *ST Xinyi Company issued on August 28, 2020, we can see that the opinions in the audit report are negative opinions. From this, we can see that the internal control of *ST Xinyi Company is seriously ineffective, and did not properly play the role of internal control.

3.3.2. *ST Xinyi has Poor Operating Performance and Strong Motives for Fraud

*ST Xinyi Company's operating income in 2018 and 2019 was less than 10 million yuan for two consecutive years, and turned losses into profits in 2019. *ST Xinyi Company has not resumed trading since its suspension in 2015. In order not to delist, tie up investors and continue to issue stocks, *ST Xinyi made false records in its 2018 and 2019 annual reports, which led to accounting firms issuing non-negative opinions, deceiving investors, disrupting the market, and causing serious consequences.

4. Conclusion of the Audit Failure Case Study

4.1. The Failure of the Firm to Maintain Independence in the Audit Process is the Direct Cause of Audit Failure

Before the start of the audit, the certified public accountant did not conduct a comprehensive investigation of *ST Xinyi Enterprise, indicating that the certified public accountant did not have a strong awareness of risk prevention, so he relaxed his vigilance in the audit work and did not conduct further audit procedures. Second, the audit evidence is also questionable [9]. In the audit work, the certified public accountant did not conduct a detailed investigation on the operating income of *ST Xinyi Enterprise, nor did they investigate the situation of the main controller of the enterprise, which is also the reason why the related party transactions were not investigated and dealt with. In addition, Tangtang Law Firm requires employees who have been employed for only three days to issue an annual audit report of a listed company, which shows that the certified public accountant did not independently conduct audit procedures that conform to the procedures. CPA lacks a rigorous professional attitude, lacks professional suspicion, and lacks independence in work, but these are all qualities that CPA must have. Regarding the financial fraud case of *ST Xinyi Enterprise, Shenzhen Tangtang Accounting Firm did not question the abnormal rental offset income it confirmed during the audit of the 2019 year-end financial report of *ST Xinyi Enterprise, nor did

it find any errors in the annual report. In the end, a wrong audit report was issued, which led to the failure of the audit.

4.2. *ST Xinyi Financial Frauds is the Internal Cause of Audit Failure

From the perspective of listed companies, it is mainly based on the maximization of their own interests, in order to achieve the strategic goals of the company, so as to produce beautiful statements through financial fraud. At this stage, in order to be listed or not delisted, domestic listed companies will falsify financial data through various means to achieve their goals. And *ST Xinyi Company is also in order not to delist, inflated income, and beautify the report. Therefore, *ST Xinyi's financial fraud is the internal reason for the audit failure.

4.3. Inadequate Supervision of the Audit Industry is the External Cause of Audit Failure

The CSRC's penalties for audit violations are relatively light, usually administrative penalties, which do not play a corresponding role. For serious circumstances, there is no revocation of the membership of the association. The punishment is limited, so the price it pays is limited, so under the temptation of huge benefits, auditors are very likely to ignore professionalism, violate morality and make illegal auditing behaviors [10-11]. The frequent occurrence of audit violations is partly due to the insufficient penalties imposed by the regulatory authorities on accounting firms for violations. Some auditors and audit institutions are tempted by interests to complicit in the audited companies, turning a blind eye to their financial fraud and issuing unqualified opinions, and finally lead to the phenomenon of audit failure.

5. Governance Countermeasures of Audit Failure

5.1. Strengthen the Independence and Professional Competence of Certified Public Accountants

In the process of auditing, the auditors are mainly responsible for the audit work, so the audit quality mainly depends on the ethics and professional level of the certified public accountants. Certified public accountants should strengthen their professional knowledge, so as to promote the improvement of audit quality, which is also what accounting firms need to pay attention to. In the process of recruitment, accounting firms should pay more attention to the moral quality of candidates. Pre-job training is required after admission, so that the audit review ability of auditors can be continuously improved [12]. At the same time, accounting firms must continuously improve the moral and professional qualities of auditors, improve the internal supervision of the firms, and increase the intensity of control. In addition, for the certified public accountants themselves, there must be continuous improvement of self-awareness. After obtaining professional qualification certificates, certified public accountants also need to keep pace with the times and keep learning. In the process of work, you should be aware of your own shortcomings and receive corresponding training to make up for your own shortcomings, improve your knowledge reserves, and organically combine theory with practice. They should also pay attention to and study international audit cases, and then sort out and summarize according to the current situation of domestic audit, so as to enrich their own experience. In the process of continuously improving their professionalism, they should also pay attention to the cultivation of their own moral quality. We must fulfill our duties, be loyal to our post, strictly abide by relevant regulations, be down-to-earth and be strict with ourselves [13]. In the process of implementing the audit procedures, it is also necessary to be rigorous and careful,

and conduct comprehensive investigations. If any doubts are found, they should focus on the research and disclose them in a timely manner.

5.2. Optimize the Internal Control System and Governance Structure of the Audited Unit

The factors that lead to the failure of the audit are as follows: first, the management of the audited unit is facing huge performance pressure; The real financial situation does not match. After the financial fraud was made public, as well as the failure of the internal audit department of the audited company, a series of problems have attracted great attention from the society. If the audit fails, it means that the internal audit department of the audited enterprise has not played a role, turned a blind eye to the financial fraud of the enterprise, did not take timely measures, or helped the enterprise to conceal it. No matter what kind of phenomenon, it is enough to show that there are defects in the internal audit of enterprises. Only by establishing and improving the mechanism of internal audit can the role of internal audit be brought into play, then the internal audit can better supervise the daily operation activities of the enterprise, find problems and take measures in time, stop the illegal behavior of the enterprise in time, and help the financial workers of the enterprise to provide audit services for the audit. Organizations provide real audit materials, so that the audit quality can be guaranteed. In order to ensure the independence of internal audit and its role to play, internal auditors are not allowed to concurrently hold corporate management positions or financial positions, and the funds and remuneration systems required by the internal audit department cannot be affected by the personnel of the audited unit. In addition, it can refer to the successful experience of foreign countries to further improve the legal system related to internal audit and implement it effectively. In order to improve the level of internal audit, a corresponding assessment mechanism can be formulated to improve the internal audit report control system. Finally, from the perspective of the audited enterprise, it is necessary to strengthen and improve the internal control mechanism. A scientific and sound internal control mechanism can timely detect and stop the financial fraud of the enterprise. At the same time, it can also provide support for the daily operation of the enterprise and promote the stable development of the enterprise.

5.3. Establish and Improve the Market Supervision System for Auditing and Increase Penalties

The frequent occurrence of audit failures in my country shows that the supervision of the domestic audit industry is insufficient. Therefore, it is necessary to strengthen and improve the external supervision system and increase supervision to reduce audit failures. First of all, a scientific prevention mechanism should be established for audit failures and financial fraud of listed companies, and relevant laws should be issued to punish them. An audit committee can also be established to formulate a mechanism for the employment of certified public accountants. It is necessary to further improve the economic compensation system, increase the intensity of compensation, clarify the compensation process, and formulate the principle of presumption of fault for the mistakes of certified public accountants, increase the punishment for them, and make the market feel awe. Secondly, whether it is a government unit or a regulatory agency such as the China Securities Regulatory Commission, it must also play a supervisory function and cannot blindly rely on media supervision. It is necessary to enhance the comprehensive quality of supervisors, appropriately increase the number of supervisors, and determine the number of random checks every year according to the actual situation, and then compare with the previous data. We should pay more attention to accounting firms and auditors that had negative news in the past. Violations should be punished more severely. At the same time, reasonable policy assistance and institutional support will be given to enterprises with good credit. Finally, supervision also ensures fairness and

openness. In modern society, the review results can be published through media platforms such as official websites and Weibo. In this way, on the one hand, the right to know of stakeholders can be guaranteed, on the other hand, it can also be strengthen the public awareness of supervision, and give full play to the role of public opinion.

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