

The application of non-financial information in audit -- taking Zixin pharmaceutical company as an example

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Abstract: Non-financial information refers to various information and materials in non-financial form. Audit failure is that the certified public accountants come up with incorrect audit opinions as a result of failed to comply with generally accepted audit standards. This paper concluded that non-financial information is of great significance and plays an indelible role in the audit process by analyzing the audit failure case of Zixin pharmaceutical company, and studies the application of non-financial information such as ownership structure, internal control and industry status in the audit.

1. Introduction

With the boom of economy, various new industries and technologies spring up following the trend of times. At the same time, the economic market is becoming more complex than ever before.

Audit failure cases have occurred from time to time in recent years, which result in a bad effect on society and caused serious negative impact on the image of CPA economic police. Refers to why these happened, one reason is that auditors failed to make effective use of financial information, and another is that they failed to fully understand non-financial information such as the information of the audited company and the industry status. We should know that paying attention to the non-financial information of the audited enterprise can help us achieve the target of auditing, prevent audit risks and achieve audit efficiency.

2. Non-financial information

Non - financial information refers to all kinds of information that occur in the form of non - financial material which are directly or indirectly related to the production and operation activities of enterprises

Non-financial information has the following characteristics:

(1) The universality of space. Non-financial information can come from inside or outside the enterprise. In the network era, information exchange become smoother, and the access to non-financial information become more extensive.

(2) Continuity in time. The non-financial information may be related to the past events, present events or even future events of the enterprise.

(3) Non-monetary. Non-financial information usually does not appear in the form of currency, which is mostly described qualitatively

(4) Authenticity. As the non-financial information is more and more complex, and the external not pay enough attention on it, the possibility of enterprises deliberately modifying it is smaller than it of the financial information. In particular, the external financial information is more authentic, which is generally beyond the control of the enterprise.

3. The development of audit mode

Audit accounting model is a complete system composed of audit objectives, audit plans, audit standards, audit management system and audit institutions.

The audit mode has roughly gone through three stages, account oriented audit mode, system oriented audit mode and risk oriented audit mode. The account oriented audit mode only pays attention to the financial information and completely ignores the effect of non-financial information. In the case of complex business, it's really a tough task to audit. After that, the audit mode developed to the system oriented audit mode, which pays too much attention on the internal control system of the audited unit, and relatively ignores other factors and causes of the audit risk. Risk oriented audit mode is based on the systematic analysis and evaluation of audit risk. Auditors pay more attention on the non-financial information from the outside of the enterprise than before. It improves the audit efficiency and the audit effect

From the development of audit mode, we can see that non-financial information has gone through the process from being ignored to being valued, and non-financial information is playing an increasingly important role in audit.

4. Application of non-financial information in Zixin pharmaceutical company audit

Zixin pharmaceutical company is a listed company founded in 1998, whose performance in the initial stage of listing is poor. But then, its income increased sharply in 2010 because of its involvement in ginseng business. On August 16, 2011, an article published on website uncovered the truth of financial fraud in Zixin pharmaceutical company. ZhongZhun accountant office who audited Zixin pharmaceutical company issued an unqualified audit report on Zixin pharmaceutical company's false financial report in 2010, which resulted in audit failure and was punished by the disciplinary committee.

The root cause of this audit failure is the lack of professional skepticism of certified public accountants. ZhongZhun accounting firm did not maintain due caution and suspicion in the field of zixin Co's rapidly growing performance, soaring stock price and highly fraudulent related party transactions, and the risk assessment was not in place leading to the occurrence of audit failure. In fact, the financial fraud of Zixin pharmaceutical company. can be initially seen as long as the auditors carefully observe its internal control environment, macro-economy at that time, industry conditions and other non-financial information. And through that the auditors would maintain his due professional skepticism and then reduce the possibility of audit failure. Next, we will analyze the symptoms of financial fraud in Zixin pharmaceutical company from non-financial information.

4.1 Ownership structure

the more concentrate a company is, the greater risk of financial fraud. If there is a phenomenon that the shares are highly concentrated, then the shareholder in the controlling position can not only influence the resolution of the general meeting of shareholders, but also manipulate the board of directors by selecting "own person" as the director, making the corporate governance invalid. The ownership structure of Zixin pharmaceutical company is unreasonable, which shows that there are great problems in the corporate governance structure and great risks of financial fraud. Natural person shareholders Zhong Weiguang and Dunhua Kangping Investment Co Ltd are the top two shareholders of Zixin Co. Guo Chunsheng, chairman of Zixin Co, is closely related to the three major shareholders of Dunhua Kangping Co Ltd. This leads to the fact that Guo Chunsheng is the actual controller of Dunhua Kangping Investment Co Ltd. in addition, Guo Chunsheng has a special relationship with Zhong Weiguang, the natural person shareholder. Therefore, Guo Chunguang is the "absolute controller" of the whole Zixin pharmaceutical company in essence. As a result, the equity structure of Zixin pharmaceutical company is no longer the relationship of restricting each other, but "one share dominates the other". This kind of shareholder structure will inevitably create opportunities for the financial fraud of the company.

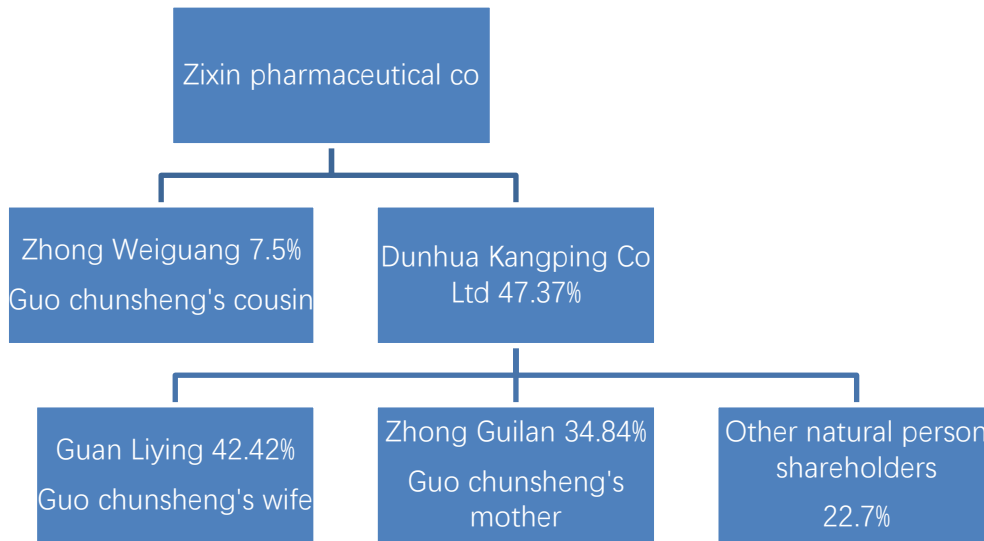


Figure 1 Equity control chart

4.2 Internal control environment

Based on the principal-agent theory, the ownership and management right of the company are separated, and the management right is transferred to the manager. A good internal control environment and system can escort the development of the company. If the rights of managers are too large, the phenomenon of favoritism and abuse of power is not only a possibility but a likelihood, which leads to the imbalance of internal control and the increase of audit risk. Guo Chunsheng who is the chairman of Zixin Co replaced all the rights of the company. He has the executive power, control power and supervision power of the company and became the controller of the whole company. What's more, the internal board of supervisors and Audit Department of the company do not work, and the independence of internal audit is poor, so it is difficult to detect the change of financial situation as soon as possible, and cannot play a supervisory role in the financial management and other related management activities of the company. Thus, it can be concluded that senior managers have the motivation and opportunity to commit fraud and the risk of financial fraud is really high.

4.3 Information and communication

If a company's information cannot be transparent, there will be obstacles in the communication of the information recipients, and the wrong decision-making or fraud can not be timely prevented and found, which increases the risk of fraud. Zixin Co is concentration and the management of the company is superior to the internal control. It can be imagined that its information transparency is so low that there is no smooth communication between the top and the bottom and the risk of financial fraud is really high.

4.4 Macroeconomic environment

From 2003 to 2006, the state issued a series of measures, such as drug price reduction, which led to the slow growth of the pharmaceutical industry. And then, the U.S. financial crisis triggered the global economic crisis in 2008, and the demand of global pharmaceutical market was insufficient, which had a negative impact on China's pharmaceutical import and export. In addition, around 2010, the amount of capital occupation and accounts receivable of finished products in the pharmaceutical industry was very high. And during this period, the price of raw materials increased caused the total cost of the pharmaceutical industry rose, which resulting in low profits. At the time of IPO in 2017, Zixin Co was uncompetitive in the market, and its sales performance was unsatisfactory with a net profit of about 560 million. In 2010, the company made amazing achievements in ginseng business and its income increased sharply. It is curious that the purchase amount of its top five customers was

only 10% of the operating revenue of that year in 2009, but in 2010, increased to 36%. Under the influence of adverse economic environment and poor industry conditions, the management of Zixin Co is likely to make financial fraud as they want to meet the needs of external expectations and personal interests. Moreover, related party transactions are the high incidence area of financial fraud. Zixin pharmaceutical company and its customers have many transactions with large amount and significant difference in time and amount, which shows that this area should be the focus of CPA review.

Table 1 Basic financial data sheet from 2007 to 2010

	2017	2018	2019	2010
Total assets	455261921.57	545980586.38	655193783.69	2569265077.05
revenue	170649245.31	223332334.13	256287604.81	642417445.93
Top five customers' revenue	52213189.56	29289597.72	26839493.83	232580302.39
Net profit	47956853.90	53329645.80	61084165.68	173165552.10
Operational Cash Flow	21285166.78	25668569.73	12807145.81	-215418190.86
EPS	0.74	0.44	0.30	0.84

4.5 Industry characteristics

The high threshold of domestic market access and the rapid development of foreign pharmaceutical manufacturing industry make domestic pharmaceutical enterprises face more and more fierce competition. In addition, the technology of pharmaceutical industry is updated rapidly, and there are problems in drug research and development. At the same time, the whole production process of drugs is very complex, involving many links such as mixing, crushing, and so on. If one link fails, it will affect the quality of drugs, and then affect the efficacy. In addition, in the process of drug production, some chemicals and drug residues may be discharged, which is likely to cause environmental pollution. All of the above factors have increased the audit difficulty of Zixin pharmaceutical company. Certified public accountants should be more vigilant and always cautious.

5. The significance of non-financial information in audit process

Through the analysis of the non-financial information of Zixin pharmaceutical company, we can see that the non-financial information is of great significance in the audit process.

5.1 Help certified public accountants effectively identify the risk of fraud and assess the risk of material misstatement.

Non-financial information can effectively forewarn management fraud. For example, the chaotic governance structure and the lack of internal control will reduce the difficulty of management fraud; competitive environment, industry conditions and the pressure of profit growth indicators formed during the listing process are more likely to prompt the management to commit fraud. Through the analysis of non-financial information such as ownership structure, governance structure, internal control, macro-economy and industry risks, it can help certified public accountants effectively identify the risks of fraud and estimate the level of material misstatement.

5.2 Help certified public accountants identify major risk areas, allocate audit resources reasonably and improve audit efficiency.

As a kind of indirect evidence, non-financial information of enterprises has incomparable advantages over direct evidence. It is beyond the control of management, so it is often more persuasive than direct internal financial information. Indirect evidence and direct evidence corroborate each other, which is of great significance for auditors to find valuable clues, determine audit key areas, and reasonably allocate audit resources.

6. Advice

With the organizational form and economic business of the enterprise become increasingly complex, the management is likely to make financial fraud for interest, and use their positions to cover up the fraud through a series of means.

A complete method of cost is able to achieve the result that account book are consistent with voucher and accounting accuracy, so as to achieve the purpose of concealing people's eyes. Only from its financial information analysis of the enterprise's internal control, may appear to run well, in fact, the internal control requirements of mutual constraints not only no longer exist. Therefore, the certified public accountant should jump out of the shackles of financial information such as account statement, and try to observe non-financial information such as internal and external information of the enterprise, and then, comprehensively analyzes and reviews various factors which affecting the economic activities of the audited unit, so they can determines the scope and key points of the audit according to the obtained quantitative risk level indicators, so as to improve the audit efficiency and reduce the audit risk.

7. Conclusion

Many certified public accountants still only focus on the accounts audit and ignore the role of non-financial information although the audit mode is risk-oriented audit nowadays. With the increasing complexity and variety of audit engagements, it is not enough to focus solely on financial information. We know that non-financial information is the basis of risk-oriented audit. Therefore, it is of great value to realize audit objectives and prevent audit risks by paying attention to and making good use of non-financial information.

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