

Auditing Risk Preventions and Control Measures of Accounting Firms in the Financial Crisis Environment

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Abstract: In modern economic activities, the role of auditing has become increasingly prominent. Under the financial crisis environment, the market fluctuates violently, which is impacting various economic entities, and the economic environment is more complicated. Whether the audit risk is potential or obvious, its level is rising. The uncertain factors in the audit work become more, which increase the audit risk. This paper analyzes the auditing circumstances and the audit risk factors in the financial crisis environment. For the internal and external accounting firms, this paper proposes targeted countermeasures for controlling and preventing the audit risk, such as promoting and improving the relevant norms and policies, purchasing audit liability insurance, improving the public credibility of the accounting firms.

1. Introduction

In the process of global economic integration, the financial crisis has also spread all over the world, and its influence covers most industries, causing some enterprise sustainable management crisis. To respond the audit risk, which is brought by financial crisis, has become a top priority for certified public accountants and accounting firms.

2. Definition of audit risk of Accounting firms in financial crisis Environment

Audit risk refers to the possibility that the financial statements have material misstatements and the CPA has issued an inappropriate audit opinion. Audit risk is universal, potential and controllable. With the market risk and the complexity of modern audit projects increasing, the auditing risk of accounting firms also increases. The audit risk of accounting firms in the financial crisis context refers to the possibility of accounting firms suffering losses in financial crisis environment.

3. Factors affecting the Audit risk of accounting firms in financial crisis

The auditing relationship generally refers to the economic responsibility relationship, which is formed by the auditing subject, the auditing object and the auditing principal. It is the premise and guarantee for the auditing activities' effective implementation. It is also closely related to the auditing risk. Therefore analyzes the auditing risk of accounting firms in financial crisis according to the auditing relationship.

3.1 The impact of the financial crisis on the audited units

(1) Under the financial crisis, the international and domestic economic situation is turbulent, and the market environment makes enterprises operating management more complicated and severe. The industry and operating conditions of the audited entities also fluctuate accordingly. At this time,

financial institutions usually adopt a contraction attitude for special periods. Under this type of funds management, corporate finances are under pressure and the capital chain is tight. In the global financial crisis context in 2008, China's financial reserve ratio continued to rise for the first three quarters, and many SMEs' capital chains were fractured. The difficulty of enterprise financing has increased, which has resulted greater uncertainty in its ongoing operations.

(2) Under the financial crisis environment, fraud risk is high. In order to get rid of the negative impact of the financial crisis and achieve its intended goals, the fraudsters often adopt some fraudulent means: the manipulation and falsification of accounting records and information of the financial statements, the arbitrary change on accounting policies, and the concealment of important facts that may affect the amount of the financial statements, etc. For example, an investment company converts an equity investment accounted by using the equity method originally into an equity investment accounted by the cost method to reduce losses.

3.2 Financial crisis brought the wave of corporate mergers and acquisitions

(1) Under the global financial crisis, mergers and acquisitions have become a helpless but effective self-help choice for many enterprises to fight against the crisis. In order to get out of the economic downturn as soon as possible, the Chinese government has promulgated industrial adjustments and revitalization plans to promote mergers and acquisitions, and at the same time accelerate the pace of overseas mergers and acquisitions. For accounting firms, a large number of jobs have been undertaken, and the number of potential risk clients has become more, and the audit risks have also increased correspondingly.

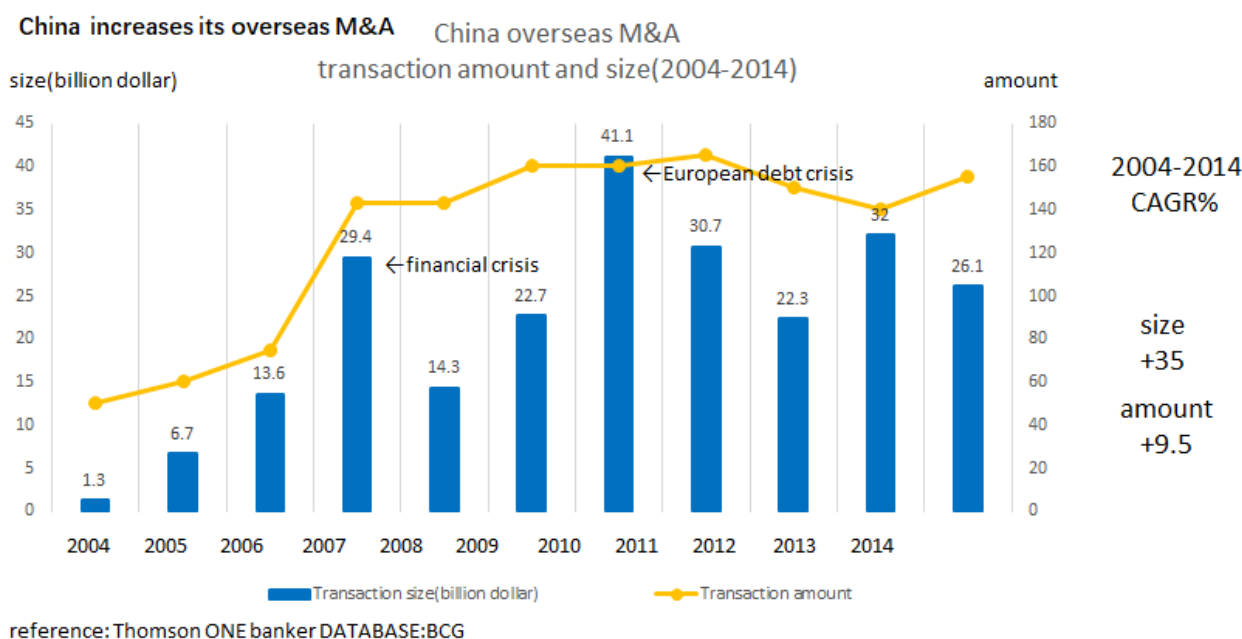


Figure 1. China overseas M&A transaction amount, size and CAGR

(2) The auditing requirements of M&A activities are more complicated, and the fuzzy factors become more and more, which increases the difficulty of auditing work and the level of auditing risk. In the financial crisis environment, all comparative indicators and benchmarks need to be updated. CPAs need to integrate the current status closely of the industry to implement the substantive analysis programs, and apply the benchmarks carefully, focusing more on comparative analyses of trends in the same industry than in previous periods and paying more attention on external comparable information than internals. CPAs should also prevent from entering the analysis programs' misunderstandings, such as unreliable data, negligence of the special circumstances of the audited entities and unreasonable expectations, etc.

3.3 The impact of the financial crisis on CPAs

Most CPA firms value the professional competence of CPAs but ignore their professional ethics. As a result, a considerable number of CPAs have not established correct values. In addition to neglect of self-management and the influence from complex environment of financial crisis, audit costs become higher, moral binding becomes lower. So CPAs are prone to professional ethics problems when they carry out auditing works. The occurrence of professional ethics problems has also increased the audit risk of accounting firms, which will reduce their reliability and damage their image.

4. Suggestions on how to prevent and control the risk of the Accounting Firm in Financial Crisis



Figure 2. Audit risk control for 3 phases

4.1 Undertake and conduct auditing work carefully

(1) Enhance risk awareness and choose customers carefully

In the financial crisis environment, the audit environment has changed violently. Before the potential stage of audit risk that before signing the contract, the CPA should get to know the basic situation of the audited unit and analyze the financial crisis impact on the international and domestic economic situation. Try to choose customers with high quality and whose risk within the acceptable range. Prudently, accounting firms can collect information through the network and select customers on the basis of information.

(2) Allocate audit resources reasonably and listen to expert opinions when necessary.

In the presence of the audit risk that is the auditing work process, the firm should assign CPAs who are familiar with relevant professional knowledge to set up an audit team, and pay attention to the work which is related to the M & A of the financial crisis. If the CPA has insufficient understanding of knowledge, he can apply for expert assistance from relevant parties, listening to recommendations and opinions of experts, to use the correct and appropriate audit procedures for testing and analyzing, and reduce auditing risks.

4.2 Implement a sound commitment system

(1) By signing a contractual document with the audited entity, define the scope of audit responsibility clearly and avoid audit risk. According to the 'National Auditing Basic Standards', when the auditing agency delivers the auditing notice to the audited entity, it shall request on paper that the legal representative of the audited entity and the financial supervisor to make a commitment to accounting information is entire, real and related to other relevant situation. The audited entity shall ensure that the accounting books, vouchers, and materials provided are complete and true, and explain the situation of the bank card households, the establishment and operation of the accounting

institutions, and the establishment and implementation of the internal control system. According to the situation, the audit team is also supposed to submit a commitment request on paper during the audit process.

(2) Each audit project team within the firm shall sign a commitment letter of undertaking for implementation responsibility to ensure to obey the auditing standards strictly and to conduct audits according to the contents and requirements of the audit implementation plan and to be responsible for audit quality and audit results.

4.3 Extract occupational risk funds and purchase audit liability insurance

(1) Under the financial crisis environment, the firm is supposed to increase the proportion of occupational risk funds appropriately to prevent auditing risks. According to the Ministry of Finance's Notice on issuance the Interim Measures for the Professional Liability Insurance of Accounting Firms, Article 25: The accounting firm established before the implementation of these Measures shall be encouraged to complete the occupation of the risk-taking fund as soon as possible within 5 years. And finish the transition of liability insurance.

(2) The accounting firm should purchase audit liability insurance. Audit risk can have minus effect if it is only digested within the audit system. After the implementation of the audit insurance system, firms and audit clients can transfer some risk losses to the insurance industry with a small amount of insurance premium. In this way, the CPA does not need to pay more funds to cope with the audit risk loss, will not go bankrupt because the audit risk is turned into a real loss which is hard to afford, and will not increase the audit cost due to excessive caution. Meanwhile, Audit technology can also be improved with savings in audit costs so that audit efficiency and quality will be better. And under the multiple influences of the financial crisis environment, once the audit risk is realized, its impact will be serious. For example, many of the forgeries in China have given a heavy blow to many firms and audit clients. The special functions and effect of audit insurance can not only resist the triggering of audit risk effectively, but also can better repair and make up when audit risk is transformed into actual loss, and reduce audit risk effectively.

4.4 Establish a sound incentive and restraint mechanism

The distribution methods of most accounting firms are income commission and individual contracts, while the proportion of profits distributed by minority shareholders is too much, which has seriously hampered the enthusiasm of CPAs and inevitably caused moral deviation. Under the influence of the financial crisis, it is more prone to brain drain, resulting in credibility crisis of the accounting firm, affecting the quality of audit reports and increasing auditing risk.

4.5 Improve CPAs' professional qualification and encourage innovations

In the context of financial crisis, the firm should pay attention to professional competence and follow-up professional ethics education and strengthen professional ethics construction to avoid professional ethics problems, which will bring losses or risks to accounting firms under the influence of this environment.

Accounting firms should conduct regular study, etc., to encourage CPAs to propose innovative opinions and feasibility plans and combine with the current environment to perfect the working methods. Not only enhance the innovation ability and improve business level of CPAs, but improve the professional competence and professionalism of auditors. Reduce auditing risk or accounting firms from a technical perspective.

4.6 Standardize audit industry's management and improve public credibility of accounting firms

Appropriately raise the cost of CPA violations, CPAs and companies dare to falsify mainly because the cost of fraud is much lower than the gains obtained. In the special period of the financial crisis, some companies decorate financial statements deliberately and colluded with CPAs in order to

obtain more benefits. The increase in penalty costs can curb relevant behaviors effectively and reduce accounting firms' auditing risk.

In addition, the accounting firm should also use the credibility and social prestige to promote relevant laws to be improved and amended, reducing the occurrence of 'deep pocket' incidents, safeguard their own interests, and reduce auditing risks.

5. Conclusion

In the context of financial crisis, the role of auditing is particularly prominent, and the prevention and control of accounting firms' audit risk is becoming more and more important. Therefore, for the accounting firm, it is very important to improve the prevention and control system of auditing risk. The accounting firm must have a sound internal control system to ensure its independence. To cultivate accounting firms' risk awareness, we must pay attention to the professional ethics education of CPAs in accounting firms, strengthen the construction of professional ethics, ensure the auditing is objective and fair, resist the generation of auditing risks effectively, and promote the development and prosperity of the auditing industry.

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