

# Reflection on Audit Responsibility of Changchun Changsheng Vaccine Incident

Zhang Mingkun

International school of business administration, Jilin International Studies University, Changchun, Jilin, 130000

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**Abstract:** Changchun Changsheng has declared bankruptcy, but the issue of audit liability behind its vaccine incident will continue to be watched. In the context of the new standard, risk-oriented auditing has become a new concept and method for audit practitioners. The audit risk not only comes from financial statements and internal controls but also includes the production process of the enterprise and the risks it generates. Therefore, accounting firms and their auditors should not only deepen their understanding of the new auditing standards but also apply them to deal with auditing risks and avoid auditing responsibilities that arise when a business fails.

## 1. Introduction

Huanghai Machinery's profits have gradually shrunk since its listing in 2012. At the critical point in the time when the 7th IPO was suspended, Changchun Changsheng listed it on the back of the company through equity replacement and capital injection on July 1, 2015. After several months of asset reorganization and share transfer operations, the Gao Junfang family became the actual controller of Huanghai Machinery. According to the listed profit compensation commitments, Changchun Changsheng is required to achieve a profit compensation commitment of no less than 300 million, 400 million and 500 million yuan from the audited net profit of Grant Thornton in 2015, 2016 and 2017.

In 2017, the State Food and Drug Administration (from now on referred to as the "Food and Drug Administration") announced that the potency of a batch of Dpt produced by Changchun Changsheng was unqualified. Because of the small proportion of Dpt in the company's total sales revenue, Changchun Changsheng believes that the above matters have no significant impact on the company's current production and operation, so it was not disclosed in the 2017 annual report. On July 19, 2018, a total of 3.44 million yuan was received from the Food and Drug Administration.

On July 15, 2018, the Food and Drug Administration issued a notice: The inspection team conducted an unannounced inspection of Changchun Changsheng's production site and found that Changchun Changsheng had fraudulent records during the production of freeze-dried human rabies vaccine, which violated the drug GMP behavior. On July 17, the company announced the recall of all rabies vaccines on sale. The investigation was suspended on July 22. On November 7, 2019, Changchun Changsheng announced the suspension of production.

## 2. Analysis of Audit Responsibility of Changchun Vaccine Incident

After Changchun Changsheng acquired the backdoor listing of Huanghai Machinery through equity replacement and capital injection, in order to fulfill the promise of profit compensation, Changchun Changsheng has achieved rapid annual profit growth through different means, even by illegal means. The profit and profit margin of each year before and after its listing is as follows:

Table 1. Profits and profit margins before and after listing

Year	Operating income/yuan	Operating profit/yuan	Net profit/yuan	Net interest rate
2012	432,642,400.93	144,758,118.00	127,392,380.02	29.45%
2013	444,183,769.39	141,937,740.43	129,818,922.27	29.23%
2014	622,616,480.03	236,680,989.56	207,855,888.92	33.38%

2015	795,515,837.27	343,954,832.92	293,082,084.43	36.84%
2016	1,017,909,719.76	497,835,587.16	428,586,258.82	42.10%
2017	1,553,373,907.11	665,857,984.63	567,671,104.39	36.54%

Observing the above table and combining with the punishment decision, we can know that from 2015 to 2017, although it did not reach the amount stipulated in the compensation agreement in 2015, it has reached the standard in three years. Changchun Changsheng's profits increased rapidly after listing. It mainly benefited from rabies vaccine products. The operating income in 2016 and 2017 was 490,671,482.34 yuan and 734,259,490.13 yuan, respectively, accounting for 48.34% and 47.70% of Changchun Changsheng's operating income in the year.

According to the analysis of the financial audit report and internal control audit report for 2015-2017, Grant Thornton has paid attention to the problems in its statements and internal control. However, it has not sufficiently identified its audit risks and the phenomenon of abnormally high-profit margins. Nor did it attract special attention. During the execution of the audit procedure, no obvious unqualified financial problems and internal control problems were found. During the period, the financial statements issued standard unqualified audit opinions.

### 3. Audit risk analysis

The risk of material misstatement has an inverse relationship with the inspection risk. That is, the higher the risk of material misstatement, the lower the audit risk of the CPA while maintaining the audit risk unchanged. Therefore, the risk of significant misstatement in the Changchun Changsheng vaccine incident is determined by the inherent risks of auditing and the risks of control.

① In order to fulfill its 2015 profit compensation commitment, Changchun Changsheng had to choose to increase profit indicators by expanding production scale, lowering production costs, and even at the expense of product quality, thereby improving market reputation, but the profits from backdoor listings were compensated to Changchun Changsheng. The huge operating pressure has also become one of the inherent risks of auditing by accounting firms. Besides, the risks of "product quality indicators meeting national standards" issued by relevant government departments' ineffective supervision of product quality are all "passed on" and "superimposed" into audit risks.

② Changchun Changsheng's industry belongs to the pharmaceutical industry, which is a high-risk and high-return industry. The profits differences of various companies within the industry are also relatively large. Generally speaking, the profits of generic drug companies are low, and the profits of innovative drugs are high. The product production structure of enterprises is also very different, and it is difficult to use the average profit level of the industry to define whether their profit indicators are standard. Changchun Changsheng is likely to use this profit "black hole" to conceal the fact that it is financially fraudulent. At this time, it is difficult for the certified public accountant to determine the profit amount that its products can generate accurately.

### 4. Control risk analysis

① The corporate governance structure is malformed. The company's legal representative, chairman, general manager, and chief financial officer are all the same people, and they act in concert with their relatives. They have absolute control over Changsheng Biological, providing a unique environment for long-term fraud. Governance within the governance layer is subject to joint fraud, forcing internal supervisory agencies to fail, while the board of supervisors and independent directors or participating companies in joint fraud, or because of their laziness, can not supervise the enterprise due.

② The internal control system is useless. There are false records in the 2015-2017 annual report and the internal control self-evaluation report. The manufacturing of fake drugs and the company's slogan "Complete internal control improves risk identification and risk prevention capabilities", "Quality is the lifeline of the enterprise" The product quality objectives of "and after inspection, the company established an internal control system in accordance with the requirements of relevant

laws and regulations and the actual situation of the company in the previous year. There were no major defects and it was effectively implemented." As a senior accountant, the chairman is familiar with the auditing process of auditors, creating the illusion of "perfect internal control, good operation, and qualified product quality," deceiving Grant Thornton and other third-party oversight agencies, and increasing audit risk.

③ Loss of corporate values. The vaccine incident was the result of a combination of financial fraud and product fraud. In order to complete the profit indicators, the grassroots employees were forced to use expired stock solution blending and different batch blending methods to reduce production costs, improve corporate profits, and make false productions. Layers of counterfeit records and collusion have covered up fraudulent financial statements, which led to vicious vaccine fraud cases.

## **5. Inspection risk analysis**

In the face of companies with a significant risk of misstatement, auditors should fully evaluate audit risks, especially paying attention to abnormalities in financial data, and reducing the impact of risk on auditors by reducing the risk of audit inspections.

For accountants who have worked in the industry for decades, Grant Thornton did not fully identify Changchun Changchun's existence of certain hidden and unique audit risks following the new standards. Instead, it relied on past audit experience or habits and chose inappropriate audit procedures. As a result, the effectiveness of the audit process was greatly reduced, and the diligence obligation was not fully fulfilled; coupled with the long-term cooperation with Changsheng Biological, it lost its sufficient caution and vigilance and became a "blind spot" for risk identification in the Changchun Changsheng audit process. , Not to reasonably cautious of its increasing high-profit margins.

## **6. The relationship between audit risk and audit responsibility**

Auditing risks are closely related to auditing responsibilities. The higher the auditing responsibilities assumed by auditors, the greater the auditing risks. Auditors' audit responsibilities are positively related to public expectations. Therefore, the Changchun Changsheng vaccine incident not only seriously threatened the property rights of small and medium shareholders, but also threatened the lives of the people to a great extent, and a certain extent destroyed the image of domestic vaccines in people's hearts. Behind the vaccine, the incident is loopholes in Changsheng's internal control and the lack of moral character of management personnel, which adds an excellent audit risk to the auditors. The high-risk vaccine industry itself makes the public expect the responsibility of auditors to increase. After the occurrence, the CPA should bear the auditing responsibility that is in line with the expectations of the public, so the high audit risk makes the auditing responsibility very high. In fact, in the audit process, in order to reduce the audit costs, the auditors have not fulfilled their due diligence obligations, so they should also bear the corresponding audit responsibility for the audit.

## **7. Audit responsibility analysis**

In the Changchun and Changsheng vaccine incident, Grant Thornton's main responsibility was: lack of a prudent perspective on its growing profit margin, ignoring the possibility of "the fact that companies reduce costs and increase profits through false product quality," and did not fully identify Risks and measures to deal with risks in advance. Auditors did not agree with the concept of risk-oriented auditing under the new standard and eventually issued inappropriate audit opinions. In the process of audit execution, they also failed to make full use of the professional intervention following the requirements of the standard. The audit process in order to obtain objective and fair audit results.

Certified public accountants should improve their professional accomplishments and practices

and their ability to identify potential audit risks. Backdoor listed companies have tremendous profit compensation pressure shortly after listing and are themselves exposed to the risk of financial fraud. At the same time, the pharmaceutical industry is an important industry related to the national economy and people's livelihood, and it is also a high-profit and high-risk industry. Therefore, under the premise of superimposed risks, the CPA should thoroughly analyze the risks of the audit project during the pre-audit process, formulate risk identification and control measures, increase risk pre-control capabilities, and further improve professional cultivation and practice.

The accounting firm and its certified public accountants should update their auditing concepts. Under the new standard of risk-oriented audit, the auditor's lack of understanding of the products of the audited unit and its production and operation processes is an essential reason for the increased audit risk. Therefore, at the beginning of the audit business, the CPA should not only fully grasp the financial statements and internal control status of the audited unit, but also have a necessary understanding of the production process, cost management process and product quality control of the leading products of the audited unit. Therefore, strengthen the knowledge composition of auditors, to develop equivalent and complete audit procedures to avoid auditors' audit risks.

The accounting firm should strengthen the training of employees' professional competence and professional ethics. First, accounting firms should do an excellent job of summarizing and collating relevant audit information in the industry. If necessary, organize experts to conduct macro analysis, identify potential audit risks, formulate practical risk aversion measures, and use this as an opportunity to organize employees to conduct intensive training and strict assessment to strengthen employees' risk awareness further. The second is to establish an audit mechanism for auditors to prevent auditors and audited entities from invalidating their independence due to long-term cooperation. The third is to improve the industrial insurance system at the national level, to protect the employees participating in the audit with the system, and to avoid the risks to the auditors caused by the "Black Swan" incident.

Speed up the construction of the informatization platform and reduce the audit risk caused by the "islands of information." Due to the limitations of specialization and the factors authorized by the audited unit to the certification unit, different certification units have different information on the enterprise in their respective fields, and therefore issued different certification opinions or recommendations, which cannot completely cover the audited unit. All-round problems, so that the financial supervision and production supervision have the disadvantages of "singing their tunes and playing their trumpets." Therefore, in the process of auditing, the accounting firm should actively seek links with other assurance, services, and intermediary agencies, such as law firms, product-related research institutes, and administrative appraisal centers. The government should also publicize the corresponding information in a timely manner, and provide different intermediary agencies with an informatization platform to connect with each other, make full use of the rights authorized by the enterprise, and clearly divide their corresponding risks to reduce the responsibility of non-stakeholders.

Improve the listing and delisting review process and improve the delisting mechanism of listed companies. Due to the frequent suspension of IPO listings, cumbersome IPO listing procedures, and lengthy approval cycles, backdoor listings have the advantages of shorter approval times and higher success rates than IPO listings. After the listing, the original shell company still exists, especially in the form of a solid shell, the borrowed company still retains its business. The borrower needs to make a profit compensation commitment before listing to enhance investor confidence. However, the new company's continued operation is a This burden and performance pressure have become the direct cause of corporate fraud. Therefore, if the securities market supervision tips are improved and the delisting mechanism of listed companies is improved, the companies that were initially poorly managed will be delisted promptly. At the same time, for some outstanding companies, speed up the IPO listing approval time, to curb the audit risks of backdoor listed companies from the source.

## **8. Conclusion**

The Changchun Changsheng Vaccine incident is a typical case of financial fraud passing on

product fraud. When facing the performance pressure of backdoor listing for profit compensation, and the company's operating capacity has not reached the set goals or hopes to increase profits to attract investors, the company Choosing to cheat to maintain the constantly rising stock price and enhance investor confidence in the company's investment. However, in similar incidents, companies' fraudulent use of financial data on production records has increased the difficulty of identifying audit risks and increased the audit risk of audit work but objectively promoted the in-depth promotion of risk-oriented audits.

At the same time, it has multiple high-risk auditing operations. The CPA should pay more attention to sensitive information and improve the ability of risk identification to reduce the audit risk in the work process. The level of audit risk is closely related to the degree of information asymmetry. Therefore, in the professional process, we should not only strengthen the connection with the personnel of the audited unit, but also strengthen the connection with other professionals with professional ability, and sensitively sense the social and economic environment and the audited. Unusual changes in the unit, identify and respond to unique audit risks, make timely adjustments to audit procedures, and reduce audit risks.

Not only should auditors implement the requirements of auditing standards, but government departments should also improve the listing and delisting system, thereby improving the operating environment of listed companies and creating a good audit environment.

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