Strategies for Integrating Internal Control Audits with Financial Statement Audits

Yuqian Huang, Li Gong, and Fen Xiao

Abstract—The proper integration of internal control auditing and financial statement auditing has certainly been fruitful in practice. However, internal control audit and financial statement audit are two independent audits, and if they need to be integrated, it is necessary to think carefully about the reasons and directions of integration. Combining the current status of the implementation of internal control audit of listed companies in China, it is easy to find that the reference standards for integrated audit issued today are still not sound, and some accounting firms have implemented integrated audit, but they have not been able to highlight the advantages of integrated audit. In view of this, this paper focuses on the practical application of integrated audit, and selects the integrated audit of the delisted Boyuan by Asia Pacific (Group) CPA firm as the case study of this paper to discuss the necessity of its integration, analyze the possible problems in its integration and give improvement strategies, in order to bring new ideas for integrated audit in China.

Index Terms—Audits of internal control, audit of financial statements, integrated audit, delisting bo yuan, audit of public companies.

I. RESEARCH ON CASE BACKGROUND

A. Main Research Objects

Zhuhai Boyuan Investment Company Limited (later referred to as "delisted Boyuan") is a generalist company focusing on investment and management. On 12 May 2016, Boyuan's board of directors announced the termination of its listing. In the 26 years between its listing in 1990 and its compulsory delisting in 2016, the company has undergone several restructurings, and both its name and its controlling shareholder have undergone several name changes and replacements. The main business areas have also changed from the production and sale of daily-use chemical products to consulting and wholesale and retail of commerce before delisting.

Information on the replacement of an accounting firm is shown in Table I.

Asia Pacific (Group) CPA (Special General Partnership) (hereinafter referred to as "APA") is a national, comprehensive and large accounting intermediary group. The business areas cover audit assurance, tax services, management consulting and other diversified services. In 2015, the delisting of Boyuan was carried out by APAC for its integration audit.

TABLE I: ACCOUNTANTS HAS CHANGED ITS NAME SEVERAL TIMES

<table>
<thead>
<tr>
<th>Year</th>
<th>Name</th>
</tr>
</thead>
<tbody>
<tr>
<td>1984</td>
<td>Henan CPA Firm.</td>
</tr>
<tr>
<td>1993</td>
<td>Asia Pacific Accounting Firm</td>
</tr>
<tr>
<td>1998</td>
<td>Asia Pacific Group CPA Firm (absorbed Shenzhen Asia Pacific CPA Firm and other units)</td>
</tr>
<tr>
<td>2001</td>
<td>for Asia Pacific (Group) Chief Accounting Firm Limited (restructured by decoupling)</td>
</tr>
<tr>
<td>2013</td>
<td>Asia Pacific (Group) CPA Firm (Special General Partnership)</td>
</tr>
</tbody>
</table>

B. Research Background

China's five ministries and commissions promulgated the "Supporting Guidelines on Internal Control of Enterprises" in 2010, which clearly stipulates that CPAs can either perform internal control audits of listed companies only or integrate the implementation of internal control and financial statement audits, which provides policy support for integrated audits of listed companies.

The China Securities Regulatory Commission ("CSRC") reformed the delisting system in 2012 and 2014. Several Opinions on Reforming, Improving and Strictly Implementing the Delisting System for Listed Companies were officially issued in 2014, and the delisting system, which is more in line with China's national conditions, made delisting Boyuan the first listed company to be terminated out of a total of 88 non-standard internal control audit reports issued in 2015.

TABLE II: HISTORY OF THE COMPANY

<table>
<thead>
<tr>
<th>Year</th>
<th>Events</th>
</tr>
</thead>
<tbody>
<tr>
<td>1991</td>
<td>The company is listed on the Shanghai Stock Exchange</td>
</tr>
<tr>
<td>1994</td>
<td>Stock transfer, 51.95% shareholding of Kangenbei Group</td>
</tr>
<tr>
<td>1997-1998</td>
<td>Three equity transfers, 41% owned by China Huayuan Group Co.</td>
</tr>
<tr>
<td>2004</td>
<td>Share transfer, 41.09% held by China Huayuan</td>
</tr>
<tr>
<td>2007</td>
<td>Stock auction, Meteorda Investment 28.32%, Xu Zhirong 12.77%</td>
</tr>
<tr>
<td>2010</td>
<td>Shareholding auction, Zhuhai Huaxintai accounted for 21%</td>
</tr>
<tr>
<td>2014</td>
<td>Investigated by the SFC in a sub-case for alleged material information disclosure violations</td>
</tr>
<tr>
<td>2015</td>
<td>Referred to the public security authorities on the grounds that it is suspected of irregular disclosure, non-disclosure of material information and forgery and alteration of financial instruments</td>
</tr>
<tr>
<td>2016</td>
<td>Boyuan was officially delisted and the company's stock was terminated</td>
</tr>
</tbody>
</table>

Taken together, the circumstances of its administrative investigation indicate that the delisting of Boyuan was a serious violation. According to the penalty report issued by
China's Securities Regulatory Commission in 2011 and the announcement of the transfer of Boyuan to the public security authorities for criminal liability in 2015, Boyuan had inflated bank deposits in 2007 and 2008, and at the same time, in order to conceal the fact that its performance commitments had not been fulfilled, the company had repeatedly forged bank In order to conceal the fact that its performance commitments had not been fulfilled, the company forged bank acceptances, falsified major transactions, inflated revenues and assets, and disclosed seriously false financial information in an attempt to send good news to the capital market.

The source references for the research based on the analysis of the combination of internal control auditing and financial statement auditing are [1] and [2]. The text of the table is self-organized.

The Company’s history is supplemented as shown in Table II.

II. DISCLOSURES AND THE NECESSITY OF IMPLEMENTING INTEGRATED AUDITS

A. Disclosure of Internal Control Audit Reports

According to the annual reports from 2011-2015, delisted Boyuan has experienced three changes of accounting firms. Zhongxing Hua was responsible for auditing 2011-2013, issuing an unqualified audit report with emphasis of matter paragraphs for delisted Boyuan in the first year, and a standard unqualified audit report in the last two years. 2014 Boyuan switched to Dahua for the audit, issuing an unqualified audit report with a very different type of opinion from the audit report in the previous three years. 2015 Boyuan again switched to Asia Pacific for the implementation of its integrated audit.

The contents of the internal control audit report are shown in Table III.

The disclosure of the internal control audit report refers to the source [3].

<table>
<thead>
<tr>
<th>Year</th>
<th>ICA report disclosure date</th>
<th>ICA report disclosure main content</th>
<th>Certified Public Accountants</th>
<th>Audit Report Opinion</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012</td>
<td>Not disclosed</td>
<td>Not disclosed</td>
<td>Zhongxing Hua (Group)</td>
<td>Standard unqualified opinion</td>
</tr>
<tr>
<td>2013</td>
<td>Not disclosed</td>
<td>Not disclosed</td>
<td>Zhongxing Hua (Group)</td>
<td>Standard unqualified opinion</td>
</tr>
<tr>
<td>2014</td>
<td>April 30, 2015</td>
<td>A material weakness in financial reporting related to the related failure of internal control over financial reporting.</td>
<td>Dahua Accounting Firm</td>
<td>Negative opinion</td>
</tr>
<tr>
<td>2015</td>
<td>Not disclosed</td>
<td>Not disclosed</td>
<td>Asia Pacific (Group) Accountancy Firm</td>
<td>Unable to express an opinion</td>
</tr>
</tbody>
</table>

APL issued an unopinionable audit report on the delisted Boyuan, stating that it could not determine whether the financial statements of the delisted Boyuan prepared under the going concern assumption were appropriate. The details are as follows.

The first is related parties and related party transactions. In the internal control report, APA noted deficiencies in the authenticity of the related parties and related party transactions and the accuracy of the disclosed transaction information of the delisted Boyuan. 2015 annual report disclosed that the company received a gratuitous donation of 95% equity interest in Fujian Kuanyu from a shareholder, which the delisted Boyuan included in long term investment and increased capital surplus at the same time. After the audit, APL found that Boyuan did not disclose the true related party relationship with the shareholder in the annual report, and there was no way to verify whether it was the true shareholder and whether the donation was legal after implementing a series of audit procedures. The material weakness of this internal control directly led to the risk of material misstatement in the corresponding financial statement accounts of long-term equity investment and capital surplus.

The second is the improper maintenance of important original documents and accounting information. In the internal control report, APIC pointed out that there was a material weakness in internal control at the financial statement level of the delisted Boyuan, and the poor maintenance of original documents and accounting information for material transactions resulted in the auditors being prevented from obtaining evidence to verify whether the relevant transactions were genuine and the amounts were accurate.

B. The Need for Firms to Implement Integrated Audits

The advantage of an integrated audit is the ability to share audit evidence obtained from the internal control audit and the financial statement audit. The CPA needs to consider whether to use the information obtained from the internal audit work and previous years based on the actual circumstances of the business collected. There is also a need to develop an overall audit strategy and specific audit plans so as to ensure a balance between maximizing the use of audit resources and actual audit efficiency.

From a comprehensive review of APL's integrated audit of the delisted Boyuan, it can be seen that APL firstly performed an integrated audit of the delisted Boyuan that fully utilized control testing. It then identified significant deficiencies in its internal controls such as incomplete accounting books and vouchers, and unclear related party transactions. This was followed by an analysis of the causes of the problems and the possible impact on the financial statements. In conclusion, the internal control deficiencies corresponding to the accounts related to the statements are analyzed.

For the audited entity, Boyuan, the integration of the audit provides high-quality financial information in line with the principle of cost effectiveness. For APL, the integration of the two facilitates the identification of financial audit control points. It provides clues to control deficiencies and reduces auditor workload, while the correlation between the two audit procedures can corroborate each other to reduce audit risk. In
summary, both the firm and the auditees are looking to integrate the audit to save resources for both the firm and the auditees and to reduce costs and improve efficiency.

III. ANALYSIS OF THE PROBLEMS IN IMPLEMENTING INTEGRATED AUDITING

An integrated audit is one in which the CPA expresses an opinion on the effectiveness of internal control over financial reporting by obtaining sufficient and appropriate evidence and makes a control risk assessment for the audit of the financial statements. It is easy to see that the external oversight mechanism of the CPA firm is not fair by collating the annual report and the internal control audit report. The integrated audit is an extension of the two audits, and it is because of the high business competence required of CPAs in the integrated audit that certain problems are inevitable in the implementation process.

A. Vague and Poorly Executed Integration Concept

On the one hand, it is understood that APL has not set up a separate set of integrated audit process to guide the execution of the audit. The overall integrated audit approach is vague and still focuses mainly on the financial statement audit, which makes the integrated audit of the delisted Boyuan only a formal integration rather than a substantive one. This may be related to the fact that for many years the auditing profession has placed more emphasis on financial statements than on internal controls, and auditors have chosen the controls to be tested primarily to "serve" the financial statement audit. However, the choice of testing period is still at the end of the period and if deficiencies are found, even with timely communication and rectification, it is difficult to test again within a short period of time to find that the internal controls are effective. Thus, in this case, is likely to affect the reliability of the internal control audit and the evidence obtained will not provide reasonable assurance that the internal controls were effective for the entire period required for the integration audit, thus making the audit quality lower.

On the other hand, the delisting of Boyuan was terminated by the Shanghai Stock Exchange on 21 March 2016. However, APAC issued an unavailable audit report on 29 April 2016 on the delisted Boyuan. As a professional accounting firm, APAC should have meticulously carried out a fully integrated audit of the delisted Boyuan to fully expose the problems of the audited entity through the implementation of systematic and standardized audit procedures, and should not lack in-depth knowledge of the audited entity just because the Shanghai Stock Exchange terminated the listing of the delisted Boyuan.

B. Continuous Auditing Affects CPA Prudence

In APL’s integration audit of delisted Boyuan, although the CPA’s use of information obtained from prior years' audits was agreed to by the standards, caution should still be exercised in the implementation of the auditees’ internal control audit system.

In performing internal control testing, APA implemented the audit process almost exclusively from the perspective of the internal control testing performed by UOB in FY14. This is likely to have prepared the company’s relevant personnel, resulting in insufficient audit evidence being obtained. Moreover, when the quality of audit evidence obtained from the control tests is not high, the effectiveness of the integration will be affected, and it may even affect the determination of the scope of substantive procedures. The basis of the final opinion is very similar to that found by Dahua CPA in 2015, both of which identified internal control deficiencies from the perspective of being unable to confirm the authenticity of shareholders' investments and to determine the true status of its significant foreign investments, notes receivable and replacement operations, and lacked disclosure of matters such as issues outside of the internal control system of Boyuan and the impact on the financial statements.

C. Lack of Comprehensive Talent for Integrated Auditing

Considering the late start of integrated auditing in China and the lack of clear legislative documents and working guidelines related to integrated auditing, there is still a lack of reference examples and academic research results from practical application, which also places a higher demand on the professional competence of auditors.

In this case, APA only expressed doubts about the authenticity of the significant transactions of the delisted Boyuan, but stopped pursuing the matter after one letter was sent to the counterparty, the endorsed party and the issuing bank and no reply was received. Despite the significant deficiencies in internal controls over the maintenance of accounting information at delisted Boyuan, the evidence of its audit opinion would have been more professional if the auditors had continued to pursue the matter with due professionalism.

The relevant information about Boyuan's fraud comes from the reference [4].

IV. STRATEGIES FOR INTEGRATING AUDIT REFINEMENT

A. Grasp the Situation of the Audited Unit and Standardize the Audit Integration Process

An integrated audit has higher requirements than an individual audit. For example, the ability of auditors to communicate effectively and the sharing of information between project team members need to be properly checked. Consider that internal control audits place more emphasis on process than financial statement audits. If the reviewers do not enter the audit site to properly monitor the audit, but only review the audit draft, the post-facto review will not ensure the quality of the audit. This will have a direct impact on the accuracy and fairness of the consolidated audit results. In this case, although APA monitored the financial fraud of the delisted Boyuan, as a professional auditor, it should make full use of its audit resources to uncover as much fraud as possible in the audited entity. This will provide investors with a comprehensive knowledge of the audited entity to help them make the right investment decisions.

B. Emphasize the Practice of Integrated Auditing and Sound Talent Development Model

Above all, audit practitioners themselves should establish a sense of the bottom line and set strict standards of high expectations for their overall quality. From the perspective of the project leader of the integrated
audit, the project leader should ensure a reasonable division of labor based on the opportunity for auditors to participate more fully in the entire process of integrated audit. In the meanwhile, the proportion of inexperienced interns in the integrated audit team should be reduced as much as possible. Then focus on the relevant interest subjects of the company and improve the corresponding file management.

From the perspective of the accounting firm, the talent training model can be improved. For the accounting staff, relevant training activities on integration audit should be organized regularly to learn the latest accounting and auditing tax policies. In addition, the standard of their assessment system should be made transparent and specific. Finally, make their professional ability more enough to keep up with the pace of enterprise development as well as national economic development and keep up with the times.

From the perspective of the Chinese Institute of Certified Public Accountants, a CPA integrity system should be established and a good integrity record should be made. Then, CPAs should be prompted to maintain their independence so that they can correct their audit attitude. Give some rewards to CPAs who disclose financial fraud of listed companies to encourage them to be objective and fair in the process of auditing. In this case, if there is evidence that can point out the auditors' gross negligence or even fraud, the relevant personnel and even the auditing unit will be punished accordingly.

C. Improve the Integration of Audit Quality Control and Implement Full Coverage of Information Technology

Under the background of today's rapid development of Internet information technology, the information obtained by auditing is not a single data before, and the comprehensive ability of auditors is increasingly required in the face of increasingly complex data. To effectively improve the integration of audit quality control, the implementation of audit information technology is undoubtedly a good method. From the documents issued by CICPA, it is known that 42% of accounting firms nationwide have carried out the construction of audit operation systems to varying degrees, 92.1% of large accounting firms have applied audit operation systems, and 75.6% of large accounting firms have adopted internal management and project management information systems in their daily work. On the one hand, the highly accurate statistical analysis system can help the project team to make judgments on fuzzy estimates and reduce the workload of the project team. On the other hand, the content of audit briefs is more cumbersome. Then the use of information management facilitates the retrieval of relevant information, thus improving the efficiency of integrated audit work.

Thinking from the perspective of CPAs, CPAs should have the necessary ability and relevant experience in analyzing and mining massive data. Thinking from the perspective of the CPA firm, the CPA firm should have the awareness of information technology. Be able to reasonably apply advanced information technology to audit operations, such as cloud computing, blockchain and artificial intelligence. Of course, both CPAs and accounting firms should actively explore the use of information technology in auditing. Focusing on their own informatization makes audit results more accurate and provides more comprehensive and valuable audit opinions for those who need financial information.

V. CONCLUSION

Integrated auditing has not yet reached a mature stage of development, and there is still much room for improvement and refinement. Effective integration not only further ensures the reliability of financial statements, but also enables financial audits to improve quality and efficiency, which plays a positive role in the development prospects of accounting firms, listed companies and even the economic market. This process involves not only the construction of the CPA profession itself, but also the construction of the legal system, industry regulation and other areas, which cannot be achieved overnight and requires the efforts of all sectors of society.

For one thing, we should see the big picture in a small way, identify the shortcomings in integrated auditing, and take corresponding integrated measures to focus on breakthroughs. For the other thing, we need to maintain a lifelong learning attitude, accumulate and think about the experience in the practice of integrated audit, and care about the development situation of the industry. In turn, we need to explore better ways to conduct integrated audits, so that they can improve efficiency and reduce costs while achieving the most realistic audit results.

The impact of internal control audits on audit opinions on financial statements refers to reference [5].

CONFLICT OF INTEREST

The authors declare no conflict of interest.

AUTHOR CONTRIBUTIONS

The three authors discussed the outline and worked together on the final version of the article; Yu Qian Huang was responsible for the first draft of the full article; Li Gong was mainly responsible for the passage of the integration audit of Asia Pacific Accounting Firm; Fen Xiao was mainly responsible for studying the details of the Boyuan delisting incident; all authors had approved the final version.

REFERENCES


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