Research on Income Audit of Internet Financial Information Service Industry—Take Shanghai DZH Limited as an Example

Hao-Yang WU*, Yi-Ting NIU and Yue LENG

School of Accounting, Jilin University of Finance and Economics, Changchun, Jilin Province, China, 130117

*360224240@qq.com

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Abstract. The development of social economy has promoted the rise of Internet financial information service industry in China, and the diversified service revenue recognition of this industry has brought certain difficulties to the audit work. The article starts from the difficulty of revenue recognition in the Internet financial information service industry. Taking the auditing failure case of DZH as an example, it focuses on analyzing the problems in the revenue recognition and the fault of Shu Lun Pan, and exploring the problems that CPAs should pay attention to when auditing the income of the Internet financial information service industry. Analysis found that CPAs should maintain professional cautiousness, be alert to audit risks, optimize audit procedures, standardize audit work, and clarify audit scope, obtain adequate and appropriate audit evidence, based on understanding the difficulties in revenue recognition in the industry to improve the audit quality of revenue recognition in the Internet financial information service industry.

Introduction

In March 2015, the Third Session of the 12th National People's Congress was held in Beijing. The “Internet +” action plan became a hot topic in the conference. The combination of traditional manufacturing industry and the Internet big data promoted the transformation and upgrading of Chinese enterprises. The Internet financial information service industry is a combination of products. It is a financial information intermediary service based on Internet tools such as social networking, applications and search engines. Compared with traditional industries, the Internet financial information service industry as a high-tech industry, its diversified service revenue recognition increases the audit risk faced by CPAs. The CICPA (Chinese Institute of Certified Public Accountants) has also repeatedly interviewed accounting firms, prompting to strengthen the audit of Internet finance listed companies. Therefore, CPAs should deepen their understanding of the Internet financial information service industry, pay attention to the industry's revenue recognition issues, strictly control audit risks, and improve audit quality.

With the maturity of Internet technology, the improvement of social economic levels, and the gradual enrichment of financial products, China's Internet financial information service industry has a broader market space. In the current market, mainstream information service providers include companies such as DZH, East Money, Straight Flush, and Compass. Among them, DZH, as one of the “Three Musketeers” of the Internet financial information service industry, has always been in the industry’s leading position. However, it has been punished by CSRC (China Securities Regulatory Commission) for financial fraud such as the inflated revenues. Shu Lun Pan was also penalized for issuing unreasonable audit reports. It could be seen that the ability of China's accounting firms to audit the income of the Internet financial information service industry needs to be improved.

The Analysis of DZH Income Audit

Problems in Confirming the Income of DZH

Through the comparison of DZH in the first three quarters of 2013 and the fourth quarter, it can be found that the total profit of the first three quarters of DZH is negative, and the sales revenue on
the balance sheet date is only growing sharply. It can be seen that DZH has a false increase in revenue in December. The comparison of operating income and profit between the first three quarters of 2013 and the fourth quarter is shown in the Table 1 below.

Table 1. DZH 2013 First Quarter and Fourth Quarter Operating Income and Profit Comparison.

<table>
<thead>
<tr>
<th></th>
<th>Income</th>
<th>Revenue as a percentage of the year</th>
<th>Profit</th>
<th>Profit as a percentage of the year</th>
</tr>
</thead>
<tbody>
<tr>
<td>The first three quarters</td>
<td>54106</td>
<td>61%</td>
<td>-18896</td>
<td>---</td>
</tr>
<tr>
<td>Fourth quarter</td>
<td>35319</td>
<td>39%</td>
<td>23189</td>
<td>540%</td>
</tr>
</tbody>
</table>


According to Table 1, it can be found that DZH's profit in 2013 mainly relied on the fourth quarter's revenue, accounting for 540% of the annual profit, while the main business of DZH has no seasonal characteristics. Such abnormal data has not caused suspicion of Shu Lun Pan CPA Co., Ltd. After investigation, it was found that DZH mainly had a series of problems such as confirming revenue in advance and inflating income.

**Confirm Revenue in Advance.** Before December 2013, DZH was not profitable. In order to increase revenue and make profits, DZH adopted a new sales method. DZH publicly released an advertisement on its official website on December 3rd and publicized to customers: Before March 31, 2014, if you purchase software with the price higher than 38,000 yuan, customers can apply for a full refund if they are not satisfied. The advertisement achieved a good market response as soon as it came out. The sales contract amounted to 138.44 million yuan, and confirmed the current sales income of 87.44 million yuan. On December 11, 2013, the advertisement was removed from its official website, which also created an opportunity for its revenue recognition in advance without being easily discovered by the auditing unit. According to the relevant provisions of China's accounting standards, the recognition of income must meet five conditions at the same time, and DZH cannot estimate the possibility of customer return due to the promise of refund, nor can it guarantee that the economic benefits generated by these sales can flow into the enterprise. The above sales do not meet the revenue recognition conditions, which belongs to the income in advance, and at the same time, the profit is increased by 68.27 million yuan.

**Use the Framework Agreement to Inflate Revenue.** On December 24, 2013, the audited unit DZH and Beijing Sunny Hanmy Advertising Co., Ltd. (hereinafter referred to as: Sunny Hanmy) signed a cooperation contract with a contract amount of 4 million yuan, stipulating that DZH provided services such as production advertisements. On the 31st of the month, DZH confirmed the main business income of 2.83 million yuan based on the contract of 3 million invoices issued by Sunny Hanmy. However, Sunny Hanmy is only an advertising agency, and the contract signed with DZH is only a framework contract. The framework contract is a contract. The parties have reached an agreement on the subject matter of the contract, and the contract signed by the main content is determined by the customer actually placing the advertisement to form a specific transaction and refined into a formal contract\(^1\) It can be seen that the contract signed by DZH and Sunny Hanmy is not sufficient as a basis for confirming the income, but a formal contract should be signed according to the actual needs of the customer. In addition, in February 2014, the head of DZH accounting agency instructed the subordinates to make up the unsatisfactory inventory consumption schedule and submit it to Sunny Hanmy for seal confirmation. Confirmed by Sunny Hanmy, DZH put the advertisement from September to December, indicating that Sunny Hanmy has consumed DZH 3 million in advertising resources.

**Confirm Sales Revenue through False Sales.** The development and sale of computer software is the main business of DZH. At the end of 2013, in the name of acquiring high-yielding wealth

\(^1\)According to the academic definition of frame contract.
management products and issuing new shares, DZH offered to clients and received nearly 3 million yuan of funds, which were included in the main business income. In fact, this is just a means for DZH to seek help from customers to avoid delisting. Customers who do not receive the software that DZH sells will directly send money to DZH, and note the words "Help the company avoid ST." It can be seen that the sales business is actually in name only. Through this method, DZH has increased the income by 2.78 million yuan.

The Fault of Shu Lun Pan CPA Co., Ltd.

Analysis of the reasons for the failure of the audit of DZH case is due to the fact that DZH has fraudulent behavior in confirming various incomes, which interferes with the normal development of the audit work. On the other hand, it also reflects that the certified public accountants do not maintain professional skepticism and have no standard audit procedures when auditing DZH income.

Failure to Maintain Professional Skepticism. Audit risk runs through the entire audit process, especially for high-tech companies like DZH. The business is complex and the sources of income are numerous, and the audit risk is higher than other industries. Therefore, auditors should maintain professional caution from the initial acceptance of business commissions to the issuance of audit opinions. In this audit, Shu Lun Pan CPA Co., Ltd. not only did not maintain the professional skepticism, but also easily believed in the various financial data of DZH with the mechanical execution of the audit procedures, it greatly reduced the quality of the audit. As can be seen from the Table 2 below, the major financial data of DZH in 2013 and 2012 are quite different. The difference in operating income alone is 424.13 million yuan, but it has not caused the attention and doubt of auditors.

| Table 2. Major Financial Data of ZDH in 2013 and 2012. Unit: 10,000 yuan |
|-------------------------------|--------|--------|--------|
| Main financial indicators     | 2013   | 2012   | Difference |
| Operating income              | 89426  | 47013  | 42413    |
| Operating costs               | 17569  | 16107  | 1462     |
| Management costs              | 52560  | 40742  | 11818    |
| Sales expense                 | 45579  | 26892  | 18687    |
| Net profit                    | 2419   | -26572 | 28991    |
| Gross profit margin           | 80.35% | 65.73% | 14.62%   |
| Net cash flow from operating activities | -7710 | -25311 | 17601 |


As shown in Table 2, DZH incurred a loss in 2012. If the loss continues in 2013, the company will have a risk of delisting. By comparing the key financial data of DZH in 2013 and 2012 and analyzing it, we can find the following doubts: First, compared with 2012, DZH’s operating income increased by 90%, while operating costs only increased by 9.07%. Administrative expenses increased by 29.01%, indicating that there may be suspicions of hidden costs and inflated income. Secondly, DZH’s net profit in 2013 increased by 289.91 million yuan compared with 2012. The growth of this indicator is mainly due to the growth of ZDH's fourth quarter operating income, while its net profit in the first three quarters was negative. In the fourth quarter, the revenue increased significantly before turning losses into profit. Finally, from the indicator of the net cash flow generated by DZH business activities, both 2013 and 2012 are negative, indicating that the company has problems in fund management and control. The cash inflow from operating business is less, indicating DZH’s receivables collection. Accounts receivables are too slow and there may be
issues such as confirming sales revenue in advance. For the above abnormal situation, the auditors did not maintain professional suspicion, did not carefully analyze the data, and did not verify the authenticity and accuracy of the income.

**Audit Program Design and Implementation are not standardized.** In December 2013, DZH adopted a "full refund" software sales strategy, which resulted in a substantial increase in sales revenue, but the amount of sales revenue confirmed in the current period was 87.44 million yuan, which did not meet the revenue recognition conditions. And after the sales contract took effect, an abnormal refund of 22.42 million yuan occurred. Like DZH, in the near-balance sheet date, the revenue recognized in advance by increasing the sales volume of the products, the large amount of refunds after the period is one of the most common financial fraud methods. However, Shu Lun Pan CPA Co., Ltd. did not implement the corresponding audit procedures for the reasons for product refunds, but only routinely checked the company's sales contracts, software opening permission orders, accounting documents and refund agreements. In addition, because the clients of the ZDH are mainly individual customers and the number is large, it is difficult to effectively implement the letter-of-acquisition procedure. Shu Lun Pan CPA Co., Ltd. also did not take an alternative procedure, and only checked the telephone recordings of the audit project team on the basis of the previous routine audit procedures. The audit procedures designed in the audit draft for “checking whether the selling price meets the price policy” were not implemented. It can be seen that Shu Lun Pan CPA Co., Ltd. audit procedures are not standardized in the audit process and the implementation lacks execution.

**Insufficient Collection of Audit Evidence.** Audit evidence is the basis for issuing audit opinions. Auditors should obtain sufficient and appropriate audit evidence in the audit process to support audit opinions [6]. At the end of 2013, DZH inflated revenue by 2.78 million in the name of purchasing high-yield wealth management products and paying new shares. During the auditing process, the auditor simply checked the name, amount, sales content and time of the customer recorded for the abnormal electronic receipts marked with "financial investment funds" and "new stock funds" whether it is consistent or not. The misstatement found in the audit process was based on the fact that the amount of misreported amount is lower than the importance level. The audit sample size has not been expanded, and the selected sample has not been tested for major misstatement. If Shu Lun Pan CPA Co., Ltd. can expand the scope of the audit and check the bank receipts, and it will be found that there is a significant abnormality in the summary of 48 bank statements in December 2013. The amount involved is 8.73 million yuan, which is much higher than the importance level. Therefore, in the absence of sufficient audit evidence. In the case of Shu Lun Pan CPA Co., Ltd., it is obviously unreasonable to issue a standard unqualified audit reports.

**The Internet Financial Information Service Industry Income Audit should Pay Attention to the Problem**

DZH is to avoid the market, and to increase revenue through financial fraud. Due to the complicated audit of the income of the Internet financial information service industry and the failure to standardize the implementation of the audit procedures, we have left us with the inspiration to prevent audit risks. This part mainly analyzes the problems that should be paid attention to when investigating the income of the financial information service industry from the perspective of CPA.

**Maintain Professional Cautiousness and Be Alert to Audit Risks**

The Internet financial information service industry is complex in business. CPAs should maintain professional cautiousness in auditing revenue audits and be alert to audit risks. Due to the diversification of settlement methods and the innovation of business models, CPAs should improve their professional judgment on revenue recognition policies. According to the actual situation of the enterprise, choose the most appropriate confirmation method to minimize the audit risk.

Firstly, CPAs should pay attention to the sales model and policies of the Internet financial information service industry, and analyze the income recognition conditions of companies in the same industry. In particular, it is necessary to conduct revenue confirmation audits for innovative
products, understand relevant industry risks, and ensure compliance with relevant revenue recognition policies and revenue recognition conditions for similar products in the industry. Secondly, the business model and business form of the Internet financial information service industry are different from the traditional industries and have strong professionalism. Therefore, CPAs should also listen to the opinions of experts when necessary. For example, consulting software experts to determine whether the revenue of a certain software is reasonable with the completion percentage method, communicating with financial companies about what kind of audit evidence is most appropriate as the judgment basis for the completion of a certain financial service. Finally, auditors should strengthen self-learning and exchanges, accumulate experience by participating in audit practice, improve their professional judgment on income recognition policies, and raise awareness of risk prevention.

**Optimizing Audit Procedures and Standardizing Audit Work**

**Strict Implementation of Income Analysis Procedures.** At all stages of the audit, auditors should continuously understand and assess risks, and analyze the major sales transactions and income balances of Internet financial information service companies. In particular, when there is significant fluctuation in corporate income, the income analysis program can be used to understand the causes of fluctuations. And judge the cause of the fluctuations. At the same time, CPAs should compare from multiple dimensions. For example, the analysis procedures are carried by month, by category, and by project. The income changes of enterprises and other companies in the same industry are compared horizontally, and the income of the enterprise in the reporting period and the previous period is compared.

**Check and Verify Major Contracts.** Due to the large amount of virtual product sales business in the Internet financial information service industry, it is difficult to conduct audit verification through original documents such as outbound orders and invoices. Therefore, checking contracts for major transactions is one of the commonly used methods in auditing. Regarding the inspection of the contract, it is necessary to check the main customer contract, the relevant evidence at the time of revenue confirmation, and the evidence of the delivery of the goods to check whether there is a major sales return. At the same time, the auditors should also check the sales contracts with large discounts, check with the actual performance of the enterprises, verify whether the discounts are fully delivered to the purchaser, prevent the enterprises from transferring income, and set up a “small treasury” to ensure that the sales revenue is true and legal. In addition, in order to prevent enterprises from signing false contracts and using false sales to inflate income, the CPA should check whether the contracted income and the amount of income on the VAT payment return are consistent on the basis of checking the major contracts.

**Implementation of Cut-off Test in Conjunction with Revenue Recognition Conditions.** When implementing the income cut-off test, the CPA must combine the income recognition conditions, focusing on the progress of the project completion percentage, delivery and arrival acceptance, and the date of risk compensation transfer. By checking the accounting vouchers with large income before and after the balance sheet date, the sales and inventory are subject to the closing test, and the sales documents are checked against the sales documents to check whether the vesting period of the audited entity's income is correct, and whether there is inter-deposited revenue case. In particular, there are many forms of products and services in the Internet financial information service industry, and there are differences in the recognition of diversified income. The division and confirmation of income may not be clear. By implementing the cut-off test of income, it is possible to improve the rational and accuracy of revenue recognition during the reporting period.

**Clarify the Scope of Audit and Obtain Adequate and Appropriate Audit Evidence**

**Clear Audit Scope.** Before conducting the audit business, the CPA should clarify the scope of the audit to ensure that the scope of the audit can cover risks and business priorities. The rationality of the internal control design of the sales department of the audited entity and the effectiveness of its implementation have a direct impact on the CPA's determination of the audit scope. Therefore, before auditing the income of the Internet financial information service enterprise, the CPA should
understand and test the internal control of the revenue confirmation link, and determine the scope of the audit based on the evaluation results of the internal control system of the sales link of the enterprise, including the type of customer, the type of service, and evaluation of business activity processes, pricing policies, and settlement methods.

Obtain Adequate and Appropriate Audit Evidence. The customers in the Internet financial information service industry are mostly individual customers. The effect of the CPA implementation letter is not ideal, and the financial information software of the Internet financial information service industry is mostly virtual products. It is difficult to perform the inventory process, and the reliability of internal evidence is not high. The CPAs should design and implement effective alternative procedures to obtain adequate and appropriate audit evidence, such as on-site visits, telephone interviews, and online inquiries. If necessary, the scope of the audit can be expanded to examine in detail a misstatement below the importance level with a large amount of money. By analyzing and judging the audit evidence, if the income is confirmed in advance or the income is inflated, the scope of the audit should be further determined to ensure the comprehensiveness and authenticity of the audit evidence.

References


