Abstract. As the intermediary auditor of Shanghai DZH Limited, Shu Lun Pan CPA Co issued standard unqualified opinions on the 2013 annual audit report of DZH Limited in 2014. In 2017, China Securities Regulatory Commission released the administrative penalty decision, which imposed administrative punishment on violation matters of DZH and Shu Lun Pan CPA Co and the signed CPA. The following is an analysis of the problems related to the risk audit strategies and procedures in the process of DZH audit, to further explain the audit strategies and procedures that should be implemented.

Introduction

Shu Lun Pan CPA Co was established in 1927, whose earliest founder was Mr. Pan Xulun, and a renowned master in China's accounting circle, is one of the earliest and most influential accounting firms in China. Shanghai DZH Limited is a national investment management consulting company approved by the China Securities Regulatory Commission and qualified for securities investment advisory, engaged in capital market investment consulting and related services business, with business throughout the domestic and international capital markets.

As the intermediary auditor of Shanghai DZH Limited, Shu Lun Pan CPA Co issued standard unqualified opinions on the 2013 annual audit report of DZH Limited in 2014. In 2017, China Securities Regulatory Commission released the administrative penalty decision, which imposed administrative punishment on violation matters of DZH and Shu Lun Pan CPA Co and the signed CPA. The following is an analysis of the problems related to the risk audit strategies and procedures in the process of DZH audit, to further explain the audit strategies and procedures that should be implemented.

Problems Existing in the Audit Process of Shu Lun Pan to DZH Limited

By understanding the particular case of DZH Limited and the audit process performed by Shu Lun Pan on DZH Limited, the following problems can be found in the audit process of Shu Lun Pan:

Lack of risk assessment procedures

The first significant audit procedure to be executed in the risk-oriented audit is the risk assessment procedure. However, in the audit of DZH carried out by Shu Lun Pan, the risk appraisal procedure became a mere formality without a penetrating and effective analysis to DZH Company.

If the risk assessment process is seriously executed for DZH, auditors will find the following areas of high concern and high risk of material misstatement: (1) motivation and opportunity of financial fraud in management. In the 2012 annual report published by DZH, the company suffered a massive loss of 267 million yuan. If losses continued in 2013, the corresponding stock would become ST shares. Similarly, it can also be seen from the annual report of 2012 that the operating costs and fixed depreciation and amortization expenses of DZH stack up to nearly 920 million yuan annually, that is, if DZH wants to make a profit in 2013, it needs at least 900 million yuan in revenue, while its earning was 470 million yuan in 2012, which means it needs to double its revenue in 2013. In a big picture of slumping external securities markets, deficit in 2013 seemed to
be a foregone conclusion, which is absolutely unaffordable for the DZH that needs to be expanded vigorously. Secondly, it also had been introduced previously that the stock rights of DZH is more concentrated, Chairman Zhang Changhong and his brother, sister jointly hold more than 50% of the shares, which provides a very convenient conditions for counterfeiting. (2) If the analytical procedure is put into practice in the risk assessment procedure, and the operation data of DZH is compared with that of the competitor in the same industry, such as Straight Flush and East Money Information, it will also find that there are significant risk areas of material misstatement. In 2013, the Shanghai composite index fluctuated around 2200 points, and all three companies mentioned the continuous downturn in the capital market in their annual reports. In such an economic conditions, its competitor Straight Flush’s operation revenue increased and operating profit decreased by 18.59%; East Money Information’s operation revenue increased and operating profit decreased by 109.59% as well. While, the operating data of DZH was thriving, whose operating revenue has increased dramatically, and the trading profit has reached by 300.49%. By contrast, the field of significant misstatement risk for auditors has been pretty obvious.

Inadequate audit program execution

Even if Shu Lun Pan did not implement the risk assessment procedure at the beginning of the audit, it could still find the above areas with significant misstatement risk in the regular auditing procedure of DZH. Yet, the auditors did not amend the previous audit strategy specific to the identified problems and implement more targeted audit procedures.

II. Suggestions on the audit implementation to this event based on risk-oriented audit strategies and procedures

First of all, in the audit strategy for DZH, the risk assessment process must be the one to be implemented emphatically. Before implementing the concrete audit plan, enterprises should sufficiently analyze and understand the external environment, business environment, internal control, motivation or pressure of fraud or counterfeit or pressure, at the same time, it must analyze the report data and select the financial ratios of comparable companies in the same industry for comparative analysis, so as to seek out the area of risk of material misstatement of an enterprise, thus, the audit plan can be made more pertinently and the audit objective can be realized more effectively.

Secondly, auditors should implement additional audit procedures when fraud risks are found in the audit of earnings items of specific report item.

1. Analytical procedures should be performed first. Auditing officers analyze the year-round sales data by month according to the sales content, and check whether there are obvious changes in the sales content, sales unit price, revenue recognition conditions, etc., which lead to relatively large income fluctuations in December.

2. The inquiring audit program shall be executed, and it shall be understood to the directors, sales personnel and other personnel who may be familiar with the situation in the financial department of the enterprise, if the enterprise achieves a dramatic rise in December's revenue, whether there are special articles of agreement and whether there are abnormal sales prices, etc.

3. Examinational audit procedures shall be implemented. Auditing officers shall acquire homologous documents, contracts, agreements and other materials for inspection in accordance with the information they have learned, and confirm whether the information they have learned is authentic and reliable.

4. The confirmation audit should have been used as a strong extrinsic evidence for sales revenue. However, the target customers of DZH Company are generally individuals, and the confirmation audit process may not get a reply or the reply effect is not optimal. Therefore, auditors should carry out more forceful alternative tests, choose more sample sizes, and proceed more detailed tests.

5. Auditors can disguise themselves as customers and conduct purchase consultation to salesmen of DZH, from which they may obtain sales terms or commitments unknown in the sales contract. Or choose to visit refund customers after part of the period, and learn about the agreed terms and the real reason of sales return in detail.
If auditors can execute more and more cautious audit procedures aiming at the identified material misstatement risks, they will find abnormal matters such as the special sales return terms and underselling of DZH in December, so as to falsely increase the sales proceeds and falsely increase the profits and other cheating items.

Summary

It follows that the specification implementation of risk-oriented audit is of crucial importance to the audit process and audit opinions. In the process of audit, auditing officers should first maintain the imperative professional attitude of suspicion, and strictly implement audit strategies and procedures of risk based audit, so as to rationally allocate resources, lower audit risks and realize audit purpose.

References

