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A Case Study on Audit Failure of Accounting Firm

-- Taking Ruihua Certified Public Accountants as an example

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Abstract: CPA audit, government audit and internal audit are all ways to supervise the operation and management of enterprises. Among them, CPA audit is a common way of external supervision. By issuing audit reports with appropriate opinions, CPAs can provide a higher level of reasonable assurance for the authenticity and objectivity of enterprise financial statements, which are of particular concern to the users of financial statements. However, the situation of financial fraud in listed companies is more and more serious, and the frequency of audit failure in accounting firms is also gradually increasing. This makes the public's trust in accounting firms gradually reduced, and the frequent "rollover" or even "thunderstorm" of listed companies also makes the capital market lose its due stability. Accounting firms are in urgent need of some countermeasures and suggestions to improve their audit quality and reduce the probability of audit failure. Taking Ruihua accounting firm as an example, this paper explains the concept and causes of audit failure, analyzes the current situation of the accounting firm industry and Ruihua accounting firm, studies several cases of audit failure of Ruihua, and finally puts forward some countermeasures to prevent audit failure. It provides some reference and suggestions for the audit industry to prevent audit failure.

Keywords: Audit failure; Ruihua Certified Public Accountants; Countermeasures.

1. Introduction

At present, the number of accounting firms is still increasing, the scale is also expanding, and the competition in the industry is becoming more and more fierce. Unlike the ideal tripartite relationship, the governance layer responsible for supervision chooses the accounting firm that audits the enterprise. In reality, more and more enterprises are chosen by the management to audit their own management work, so whether the accounting firm can receive business depends on the management of the enterprise. Under such direct and strong external pressure and possibly promised economic interests related to audit opinions, audit firms are likely to establish too close relationship with management, which is not allowed by audit standards. This will deeply affect the independence of the firm, and its audit quality will be greatly reduced, and may eventually lead to the failure of the audit firm. However, according to the relevant standards, accounting firms should maintain their independence and reasonably ensure the authenticity and reliability of the financial statements and other accounting information prepared by the auditees through the audit reports issued, so that the users of financial statements can have a more accurate understanding and understanding of the auditees through the audit reports.

With the national investment in accounting education, more and more talents with high accounting literacy have emerged in colleges and universities, and the number of people who have obtained CPA, intermediate and senior accountant qualification certificates has increased year by year, so the professional level and competence of auditors have been continuously improved, and the firms have gradually improved their awareness of the risk of audit failure because of the continuous occurrence of audit failure cases. It has also gradually begun to control and supervise the audit quality of its business, which also helps to maintain the stability of the securities market. However, observing the warning letters and administrative penalty decisions issued by the SFC, we can find that accounting firms still have frequent audit failures, and there are still many problems in their audit process and manuscripts that need to be improved and are not compliant enough. Therefore, the firms have been punished and warned by the relevant regulatory authorities. In some cases of audit failure, the means of financial fraud of the audited units are not smart, even more obvious, but the certified public accountants have not found that the audit reports and audit opinions are not consistent with the facts of the audited units. Faced with the doubts of public opinion and the huge economic losses suffered by investors, firms will face the punishment of relevant regulatory bodies, as well as the problems of reputation damage, customer reduction, income reduction and even bankruptcy.

Therefore, the author believes that it is necessary for accounting firms to pay close attention to the preventive measures against the risk of audit failure, improve the audit quality within the firm, and reduce the probability of audit failure by standardizing the quality control of audit procedures and working papers, maintaining the independence of auditors, and improving the professional level and competence of auditors. Therefore, the author will focus on the three audit failure cases of Ruihua Accounting Firm (Haige Logistics, Huaze Cobalt and Nickel, Kangdesin), analyze the problems in the audit process of Ruihua Accounting Firm, and analyze the problems existing in the relevant regulatory bodies, so as to put forward corresponding improvement measures. To the majority of accounting firms to provide some advice and reference.

2. Related theories

2.1. Audit failure theory

Gao Shan (2018) believes that audit failure refers to the fact that auditors have made "mistakes" in the whole audit work because they have not complied with the audit standards and relevant regulations well, so they have issued wrong audit opinions which are inconsistent with the facts. This situation mostly occurs under the fact that there is a material misstatement in the financial statements, and an audit opinion inconsistent with the relevant facts is issued (Weng Yeying, 2019). The concept of audit failure is different from that of audit risk. Audit risk refers to the fact that although auditors comply with audit standards and relevant regulations in the whole audit work, they still issue wrong audit opinions and audit reports that are inconsistent with the facts to the auditees. Relatively speaking, audit failure refers to the auditor's failure to comply with the audit standards and relevant regulations in the whole audit work due to subjective or lack of professional competence, resulting in the issuance of wrong audit opinions and audit reports that are inconsistent with the facts, which has nothing to do with whether the audited unit has failed or committed financial fraud. This also shows that auditors should comply with the law in the whole audit process.

The causes of audit failure, on the one hand, are the audit failure caused by the limited professional competence and technical level of certified public accountants and the failure to find material misstatements. On the other hand, under the background of the imperfect protection of investors by relevant systems (Wang Shuxian, 2020) and the fierce competition in the audit industry (Guo Jingyi, 2019), based on the consideration of stabilizing customers, safeguarding economic interests and enhancing their competitiven ess, CPAs have made great efforts to protect their own interests. As a result, they "joined hands" with customers with greater market influence to fabricate false prosperity to cover up real negative information (Liu Mengying, 2020), which led to audit failure (Zhang Wenbo, 2020). Audit failure will not only affect the business income and reputation of accounting firms, but also be traced by the regulatory authorities, so CPAs need a more cautious professional attitude to protect their related interests from being infringed (Wang Sheng, 2020).

2.2. Theory of factors affecting audit quality

According to the requirements of CPA professional standards and ethical standards and other relevant systems, auditors must adhere to the independence of auditing, not favor any party, and should avoid the interests of all parties (Nugrahanti, 2020). The term of office and audit quality of audit institutions have changed in the opposite direction. With the extension of the term of office of audit institutions, personal feelings may arise between management and auditors, and economic dependence may arise between them and clients, which may affect their independence (Juwita, 2020). The longer the term of office of the audit institution, the less likely the company will disclose the defects in its internal control (Gao Xuedi, 2020). Therefore, the implementation of the five-year mandatory rotation policy for listed companies does help to maintain a higher level of audit quality (Liang Ming, 2018). There is a direct relationship between the size, independence and audit quality of audit institutions. Because the larger the scale, the higher the reputation and the higher the requirements for audit quality (Bae, 2020; Hsiao, 2021; Chan, 2021). The accumulation of personal audit experience of auditors is the main way to gradually accumulate professional competence (Wu Yuqing, 2020). Auditors with rich experience and professional knowledge can better judge the potential risks hidden in the financial and non-financial information of the audited unit, so as to better improve audit efficiency (Agrizzi, 2021).

2.3. Audit failure theory

Audit failure theory mainly includes principal-agent theory, information asymmetry theory and audit conflict theory. The principal-agent theory means that the client of the audit business (the audited unit) and the trustee of the audit business (the accounting firm) have different goals and needs. When there is a conflict of interest needs, based on the theory of rational economic man, both sides will pursue to maximize their own interests. The theory of information asymmetry means that when the client has much less information about the audit quality of multiple potential trustees than the trustee itself, the client's choice of the trustee is often not closely related to the audit quality, but only out of intuitive feelings, so the client either chooses the trustee who has "conspired" with it (easily lead to audit failure). Because the total annual income of the trustee who provides lower audit quality is often much higher than that of the trustee who provides higher audit quality under the same remuneration, this makes it easier for the trustee to survive and continue (although lower audit quality can easily lead to audit failure). The theory of audit conflict is that in order to keep and obtain more funds, performance and income linked to the audit report, the audit client (often the management in reality) will hope that the audit report issued by the trustee will be a standard unqualified opinion, while the trustee should issue an appropriate audit report objectively and impartially according to the specific situation of the client. The conflict between the two is often difficult to reconcile. For the purpose of maintaining customers and guaranteeing income, the trustee is more likely to cater to the needs of management, leading to audit failure.

With regard to the study of preventive measures against audit failure, Li Huiling (2019) believes that CPAs should adhere to the principle of presumption of fraud. If they cannot prove that there is no fraud, they should be identified as fraud. If they fail to collect sufficient and appropriate audit evidence to prove the legality, fairness and consistency of the accounting statements of the audited units, they should presume that there are major errors or suspected fraud in the company. Xie Xiaojuan (2020) believes that CPAs should also study the specific provisions of auditing standards involved in punishment and study which provisions of auditing standards can protect themselves. Luo Jie (2020) believes that we should face up to the audit expectation gap and improve the anti-fraud ability. The gap between the public's demand for audit and the current understanding of audit purpose in the audit profession is called the audit expectation gap. As an objective cognitive difference, the audit expectation gap can not be fundamentally eliminated. At home and abroad, the research on audit failure cases focuses on a certain case, a certain angle or some groups, but few of them will conduct multiple audit failure case studies on an accounting firm. In this case, this paper will analyze six audit failure cases of Ruihua, an accounting firm, and give targeted measures to prevent audit failure.

3. Overview of Ruihua Certified Public Accountants and Analysis of Audit Failure Cases

3.1. Overview of Ruihua Certified Public Accountants

Ruihua Certified Public Accountants was established on February 22, 2011. Its business scope includes auditing the accounting statements of the audited units and issuing audit reports, verifying the capital of the company and issuing capital verification reports, handling the audit business in the merger, division and liquidation of the audited units and issuing relevant reports, and auditing the annual financial accounts of capital construction. Acting bookkeeping and accounting, taxation, management and other aspects of consulting, accounting training and other business.

Compared with most accounting firms, Ruihua Institute is a firm with large scale, high professional level and in line with international standards. According to the relevant announcements of the Chinese Association of Certified Public Accountants, Ruihua Institute has been ranked third, third, fourth and second in the annual business income ranking of Chinese accounting firms from 2013 to 2018. No.6, No.6, Ruihua did not enter the ranking in 2019-2021.

3.2. Case Analysis of Audit Failure of Ruihua Certified Public Accountants

The main reasons of audit failure are that the audit procedure is not in place, the ability of auditors is insufficient, and the supervision of the industry is insufficient.

3.2.1. Inadequate audit procedures

Shenzhen Haige Logistics Co., Ltd. is a limited liability company (non-listed), established on March 8, 2001 with a registered capital of 12764 million yuan. As of 2022, it is in existence (in operation, in operation, registered). Its main business is to provide customers with international and domestic, online and offline professional supply chain logistics management services.

Table 1. Fraud means and clues of Haige Logistics and measures taken by Ruihua

Fraudulent means	Fraud leads	Measures and faults taken by Ruihua
Realize the capital occupation of controlling shareholder Aoshimai through other accounts receivable	In 2014, Haige Logistics had a large amount of transactions with Aoshimai, and the total amount of debit and credit was 63.71 million yuan and 63.53 million yuan respectively.	The vouchers of other receivables have been spot-checked; Knowing that the controlling shareholder of the company is Aoshimai; Spot-check the vouchers of transactions between the two companies; Assessed as a special risk; The relevant fund transactions are reflected in the audit summary.However, no further audit procedures related to related parties and their transactions have been carried out; It is not found that Haige Logistics has not fully disclosed the relevant information of Aoshimai, and that Aoshimai has occupied the funds of Haige Logistics.

On November 14, 2016, Ruihua Institute and its two certified public accountants, Li Xihui and Wu Yaya, received a warning letter from Shenzhen Securities Regulatory Bureau: Ruihua Institute had problems in auditing the annual report of Shenzhen Haige Logistics Co., Ltd., a company listed on the New Third Board in 2014.

(1) In other accounts receivable, the procedures for auditing related party transactions are not perfect.

In 2014, the transaction amount between Hercules Logistics and Osman Investment was relatively large, with a total debit amount of 63.71 million yuan and a total credit amount of 63.53 million yuan.

In the process of understanding the business situation of the audited unit, Ruihua checked the vouchers of other receivables of Hercules Logistics and learned that the controlling shareholder of the company was Osman Investment. Therefore, Ruihua checked the vouchers between the two companies.

According to the relevant standards, Ruihua should design and implement further audit procedures to obtain sufficient and appropriate audit evidence related to related parties and their transactions (in this case, Osman Investment). If the evidence obtained is limited, it should be implemented, such as letter confirmation to Osman Investment; Access to information held by Osman Investment; Relevant audit procedures such as confirmation or inquiry to relevant personnel and institutions. If it is impossible to obtain or the relevant information disclosure is insufficient, a modified opinion report should be considered.

But in fact, Ruihua did not pay special attention to the large transactions between Hercules Logistics and Osman Investment, and did not design and implement further audit procedures. Therefore, it is not found that Osman Investment has occupied the funds of Hercules Logistics.

(2) The nature of the large capital transaction between Hercules Logistics and the controlling shareholder has not been correctly judged, and no problems have been found in the disclosure of the related party transactions of Hercules Logistics.

At the beginning of the audit, Ruihua has considered "major transaction types and major disclosures", including "related party disclosures and related party transactions", and designed relevant audit procedures (derived from Ruihua's overall audit strategy). In understanding the relevant internal controls, it was also found that there was a large amount of capital transaction between Hercules Logistics and Osman Investment, which was assessed as a special risk. Ruihua Institute also reflected the relevant capital transactions in the audit summary.

According to the relevant standards, Ruihua should design and carry out further audit procedures for Osman Investment. In the audit opinion, make a reasonable and appropriate evaluation on whether the transactions and disclosures between Hercules Logistics and Osman Investment are handled and disclosed correctly, and whether they are fairly reflected; Record the name of Osman Investment, the relationship between the two companies, the type and elements of the transaction, and other relevant information in the draft; The audit draft of Hercules Logistics in 2014 is compiled into a file, so that any professional with audit experience can have a clear understanding of the audit information of Hercules Logistics in 2014.

But in fact, there is no record of the substantive test procedure for Osman Investment in Ruihua's manuscript. At the same time, it did not make a reasonable and appropriate judgment on the nature of the large amount of capital transaction between Hercules Logistics and Osman Investment, and did not find that Osman Investment occupied the capital of Hercules Logistics. It was not found that the relevant disclosure by Hercules Logistics to Osman Investment was inadequate to the extent that some of the information that should be included was not mentioned.

3.2.2. Insufficient competence of auditors

Chengdu Huaze Cobalt and Nickel Materials Co., Ltd. is a limited liability company (listed), which is listed in the list of abnormal operations. It was established on December 26, 1990 with a 54349 of RMB 0.19 million. By 2022, it is in existence (in operation, in operation and in the register). Its main business is the sales of non-ferrous metals, mineral products (except licensed business items), chemical products (except dangerous, precursor and monitored chemicals), instruments and meters, building materials and other products.

Table 2. Fraudulent means and clues of Huaze Cobalt and Nickel and measures taken by Ruihua

Fraudulent means	Fraud leads	Measures and faults taken by Ruihua
The actual 100% holding subsidiary of Huaze Cobalt and Nickel (Shaanxi Huaze) transferred the funds to Shaanxi Xingwang through two companies, Tianmu Haojin and Zhentai Rongjia, by means of false sales contracts and bank transfers,thus realizing the transfer and occupation of large amounts of funds.	Huaze Cobalt and Nickel is a family-owned enterprise, with the Wang family accounting for 35.3% of the equity, while other shareholders have a decentralized, low or even very low proportion of equity.	Knowing that the ownership structure of Huaze Cobalt and Nickel has obvious characteristics of dominance, and judging that the internal control of Huaze Cobalt and Nickel is effective. However, it does not take into account the possibility that the management of Huaze Cobalt and Nickel overrides the internal governance, nor does it pay special attention to and focus on collecting and analyzing financial and non-financial information related to related party transactions.
	From 2013 to 2015, the entry amount reached 1.319 billion yuan, 1.362 billion yuan and 1.099 billion yuan respectively by falsely issuing bills. There were many times of transfer-in and transfer-out, a large number of transfer-in before the year and a large number of transfer-out after the year. On the count date, the actual amount of notes receivable of Huaze Cobalt and Nickel was zero. In 2015, Huaze Cobalt and Nickel also retroactively adjusted notes payable to other receivables.	Carry out audit procedures such as drawing vouchers and physical inventory for bills receivable. However, it did not pay special attention to the abnormal information of Huaze Cobalt and Nickel's notes receivable, did not design and carry out further audit procedures, and did not consider the impact of these abnormal information on the risk of material misstatement of Huaze Cobalt and Nickel's financial statements.

On January 23, 2018, the China Securities Regulatory Commission issued an administrative penalty decision on Huaze Cobalt & nickel Co., Ltd. Ruihua audited the financial report of Huaze Cobalt & nickel for 2013-2014. It is the following reasons that lead to the failure of the audit:

(1) Not aware of the potential material misstatement risk behind the shareholding structure of Huaze Cobalt & nickel

According to the relevant standards, Ruihua Institute should carry out a continuous, dynamic and constantly updated risk assessment process of collecting, understanding and analyzing Huaze Cobalt & nickel and its environment, so as to continuously update the understanding of Huaze Cobalt & nickel's financial statements and the risk of material misstatement at the identified level. At the beginning of the audit, when we had a preliminary understanding of Huaze Cobalt & nickel and its environment, Ruihua Institute shall collect and understand external and internal information of Huaze Cobalt & nickel: external information includes external evaluation on financial performance of Huaze Cobalt & nickel (analysis report, credit evaluation, etc.), industry characteristics and competitive pressure, special policies, laws and regulations, etc.; Internal information includes the nature of the company, the accounting policies used, future strategies and objectives, relevant internal controls, and existing operational risks.

But in fact, when Ruihua knew that Huaze Cobalt & nickel's ownership structure had obvious characteristics of dominance (belonging to family enterprises, the Wang family occupied 35.3% of the equity ratio, while other shareholders'equity was dispersed, the proportion was low or even very low), it not only failed to maintain vigilance, but also failed to maintain the company. Without considering the possibility that the management of Huaze Cobalt & nickel overrides the internal governance, or paying special attention to and focusing on the collection and analysis of financial and non-financial information related to related party transactions, it rashly believes that the internal control of Huaze Cobalt & nickel is effective. Audit evidence inconsistent with the real situation has been obtained.

(2) It is not noticed that Huaze Cobalt & nickel has the risk

of fraud with related parties.

According to the relevant standards, although the inherent limitations of audit will make it difficult for Ruihua to find all the material misstatements and fraud risks in Huaze Cobalt & nickel's statements, the governance and management of Huaze Cobalt & nickel should bear the main responsibility for preventing and identifying fraud. However, Ruihua should focus on the fraud and related information that will lead to material misstatement of Huaze Cobalt & nickel's financial statements. Anti-fraud audit investigation should be one of the important links of Ruihua's audit. Corporate fraud is often caused by a mixture of three factors: external pressure, implementation opportunities and self-rationalization (fraud triangle theory). Ruihua Institute should firmly grasp these three elements and carry out objective and independent understanding and evaluation of Huaze Cobalt & nickel.

But in fact, Ruihua did not notice the depression of the non-ferrous metal industry at that time, did not consider that the management of Huaze Cobalt & nickel had greater performance pressure, and did not pay attention to the transfer of assets of Huaze Cobalt & nickel. Failure to guard against Huaze Cobalt & nickel's dominant shareholding structure As a result of the above careless behavior, Ruihua did not notice that Huaze Cobalt & nickel had the risk of fraud with related parties.

The investigation shows that during the period from 2013 to 2015, Huaze Cobalt & nickel's actual 100% holding subsidiary (Shaanxi Huaze) transferred the funds to Shaanxi Xingwang through two companies, Tianmu Haojin and Zhentai Rongjia, by means of false sales contracts and bank transfers, thus realizing the transfer and occupation of large amounts of funds.

(3) No special attention was paid to the abnormal information of Huaze Cobalt & nickel notes receivable.

In the 2013-2014 annual audit report of Ruihua Institute, the notes receivable of Huaze Cobalt & nickel in 2013-2014 accounted for 38.8% and 32.4% of the total assets of Huaze Cobalt & nickel respectively. And there are many times of transfer-in and transfer-out, a large number of transfer-in before the year and a large number of transfer-out after the year. Even on the counting day, Ruihua found that the actual amount of notes receivable of Huaze Cobalt & nickel was zero.

According to the relevant standards, Ruihua should check the memorandum book of Huaze Cobalt & nickel's bills receivable. Trace the relevant original information of the bills that have been cashed or discounted or endorsed and transferred during the audit period to the end of the period; Check whether the details of the actual bills are consistent with the book value; Check the original data of the bill with larger amount to determine the reliability of its information; Focus on the bills of related parties and implement the corresponding audit procedures; Develop substantive procedures for notes receivable by designing and conducting appropriate audit procedures for identified fraud risks.

But in fact, Ruihua did not pay special attention to the abnormal information of Huaze Cobalt & nickel's notes receivable, did not design and carry out further audit procedures for notes receivable, and did not consider the impact of these abnormal information on the risk of material misstatement of Huaze Cobalt & nickel's financial statements.

According to the investigation, the chairman of Huaze Cobalt & nickel recorded 1.319 billion yuan, 1.362 billion yuan and 1.099 billion yuan respectively in 2013-2015 by signaling his subordinates to record invalid bills such as copies of bills as repayment. At the same time, Huaze Cobalt & nickel also retroactively adjusted notes payable to other receivables in its 2015 annual report.

(4) The manuscript review work of Ruihua Institute is not perfect and the review quality is poor.

Ruihua has a relatively perfect four-level review mechanism to ensure the quality of working papers. The project manager in charge of the audit business shall timely find and solve problems by checking the audit results and quality of the project team members according to the audit schedule, and seek solutions from the superior manager as soon as possible if necessary. This is the first-level review procedure. The second-level review procedures are carried out by the personnel especially responsible for the quality control of audit work in Ruihua Institute, including checking whether the working papers of each subject are consistent with the requirements for the preparation of the working papers and whether the necessary audit procedures are implemented. The three-level review procedure is similar to this, and more detailed and focused inspection and review are carried out by the personnel specially responsible for the quality control of audit work. In the four-level review procedure, the signing partner of the audit business shall conduct the final review and check, and after a complete review of the manuscript, selectively focus on the relevant manuscripts of important subjects. If Ruihua can strictly implement the four-level review procedure, the audit quality will be effectively guaranteed.

According to the relevant standards, Ruihua Institute should formulate special quality control procedures to ensure that the quality of audit projects is effectively controlled, and the project partners are mainly responsible for the quality of audit. When reviewing the audit business, Ruihua Institute should choose more experienced auditors to review the audit results of less experienced auditors. Ruihua Institute shall ensure the objectivity and independence of the review personnel, and may employ external personnel to conduct the review work when necessary; The partners of the audit project shall also review the project in a timely and appropriate manner in accordance with the review process within the Institute, resolve the differences of opinion among the members of the project in a timely manner, and ensure the appropriateness and accuracy of the audit conclusion; Partners should ensure that audit evidence of good quality and appropriate quantity has been collected and collated before issuing audit reports.

However, the audit failure of Huaze Cobalt & nickel by Ruihua Institute proves that its four-level review mechanism exists in name only and has not been effectively implemented, which makes the audit quality of Ruihua Institute not be guaranteed.

3.2.3. Insufficient industry supervision

Kangdesin Composite Materials Group Co., Ltd. is a limited liability company (listed, invested or controlled by natural persons), which was established on August 21, 2001 with a registered capital of 354090 of 0.03 million yuan, and has been in existence (in operation, in operation and in the register) by 2022. Its main business is research and development, leasing, import and export of display materials, electronic materials, thermal insulation and protective materials, extrusion materials and packaging and printing materials, and providing related technical consultation and technical services.

On July 29, 2021, China Securities Regulatory Commission (CSRC) issued a decision on administrative penalties for Kangdesin Composite Materials Group Co., Ltd. (KDX). Ruihua audited the annual financial report of KDX from 2015 to 2018. The author will analyze the following points from the perspective of insufficient supervision of the industry:

Table 3. Characteristics, measures and faults of insufficient supervision of Kangdesin

Characteristics of insufficient supervision	Measures implemented by regulatory bodies	Regulatory negligence
Low inquiry rate of investigation by regulatory agencies	Regulators obtained information from Kangdesin's two suppliers (41 in total) and two customers (92 in total), with a sampling ratio of 4.9% and 2.2%, respectively.	The sampling rate of regulators is actually lower than the verification standard (5%) they set for intermediaries.
The regulator did not conduct an adequate investigation process.	Regulators took Kangdesin's main business, optical film, as the object of investigation, and restored Kangdesin's fraudulent evidence chain according to its export of new optical film and related business of electronic products.	The overseas investigation related to the new optical film that should have been carried out was not implemented. It did not investigate Zhong Yu, the actual controlling shareholder of Kangdesin, who was strongly related to the Kangdesin case, and the Cash Management Business Cooperation Agreement signed with the Bank of Beijing.
The credibility of the regulatory body's investigation conclusion is low.	Regulators'survey results show that from 2015 to 2018, Kangdesin falsely increased its business income and profits by a large amount, but in fact it continued to lose a lot.	The conclusion is contrary to the fact that Zhong Yu, the actual controlling shareholder of Kangdesin, continued to invest no less than 10 billion yuan from the original 224 million shares from 2014 to 2018, and never reduced his holdings. Zhong Yu also signed the Cash Management Business Cooperation Agreement with the Bank of Beijing. Kangdesin's employees have been participating in Kangdesin's employee stock ownership plan for the past four years.

(1) The investigation and inquiry rate of regulatory agencies is low.

According to the relevant information reported in the "Three Focuses of Guilty Defense" of Kangdesin Hearing on November 25, 2019: Not Admitting the False Increase of 11.9 Billion Profits ", regulators only obtained the information of 2 suppliers (41 in total) and 2 customers (92 in total) of KDX, with a sampling ratio of 4.9% and 2.2% respectively. All of them are lower than the 5% inquiry rate required by the regulators in the Fujian Jinsen case. That is to say, the sampling rate of regulators is actually lower than the verification standards they set for intermediaries. The Kangdesin case, known as "the largest securities case", should require more samples to obtain more reliable and detailed evidence.

(2) The regulator did not conduct an adequate investigation procedure.

Regulators took KDX's main business, optical film, as the object of investigation, and restored KDX's fraudulent evidence chain according to its export of new optical film and related business of electronic products. However, the regulatory authorities did not carry out the overseas investigation related to the new optical film that should have been carried out: they did not confirm whether the transaction was true to the receiving enterprise, did not know the actual situation of the sale and hoarding of the goods from the freight forwarding enterprise, did not conduct a physical inventory of the goods on the spot, and did not confirm the remitter of the relevant payment to the paying enterprise. As a result, the evidence chain of fraud restored by regulators is insufficient and the credibility is reduced.

At the same time, regulators did not investigate Zhong Yu, the actual controlling shareholder of KDX, who was strongly related to the Kangdesin case, and the Cash Management Business Cooperation Agreement signed with the Bank of Beijing, which made the relevant evidence imperfect and missing.

(3) The credibility of the investigation conclusion of the regulatory body is low.

Regulators'survey results show that KDX has inflated its operating income and profits by a large amount from 2015 to 2018, but in fact it has continued to suffer substantial losses.

But in fact, Zhong Yu, the actual controlling shareholder of KDX, continued to invest no less than 10 billion yuan from the original 224 million shares in 2014-2018, and never reduced his holdings. At the same time, Zhong Yu also signed the Cash Management Business Cooperation Agreement with the Bank of Beijing. KDX employees have been participating in KDX's employee stock ownership plan for the past four years. If the findings of the regulatory authorities are true, then the behavior of KDX's actual controlling shareholders and their employees violates the assumption of rational economic man.

In addition, according to relevant laws and regulations, if the management and management of KDX are charged with the crime of misappropriating and embezzling the assets of listed companies, they will be subject to criminal penalties ranging from less than 5 years to more than 10 years. However, if it is only a false increase in income and financial fraud, it will only bear the penalty of up to 600000 yuan and the prohibition of industry entry. Therefore, considering the pros and cons, the management and management of KDX are likely to collectively retract their confessions and admit fraud.

(4) Regulators have not achieved fairness and impartiality, and there is a suspicion of presupposition.

In the case of a brief sample inquiry and inadequate investigation procedure in the Kangdesin case, the evidence obtained by the regulator is actually insufficient to support its conclusion. On this basis, the authenticity and credibility of the survey conclusions, compared with the actual situation of KDX2015-2018, are also doubtful and greatly discounted. At the same time, regulators did not pay attention to the strong complaints of small and medium-sized investors against Zhong Yu, the actual controlling shareholder of KDX, and the Cash Management Business Cooperation Agreement signed with the Bank of Beijing, and even tried to avoid it.

Similarly, regulators simply confirmed the account balances of KDX and its subsidiaries to the Bank of Beijing, without further investigation or restoration of the assets of KDX and its subsidiaries.

All these actions show the hasty, irresponsible and deviant working attitude of regulators. Instead of calling it the product of insufficient evidence, it is better to suspect that it is a presupposition drawn by regulators through a simple list of evidence.

4. Reasons for audit failure

4.1. Reasons for Certified Public Accountants

4.1.1. Lack of professional competence

In the actual audit, there are usually two kinds of lack of professional competence: true lack and false lack.

The true lack is reflected in the fact that firms usually recruit a large number of interns in the busy season to engage in relatively simple audit work such as spot-checking vouchers, preparing audit manuscripts, receiving and sending letters of inquiry, checking inventory, checking fixed assets, and filling in statements. However, interns are often inexperienced and can only complete this kind of audit work formally, but it is difficult to identify misstatements and frauds through all kinds of financial and non-financial information obtained, which makes the audit procedure become a mere formality and lose its due quality.

The lack of fraud is reflected in the fact that CPAs with more audit experience often simplify the audit procedures because of the contradiction between the urgent audit time and the numerous audit services, do not strictly abide by the audit standards, and devote less attention and energy to a single audit service, which makes many obvious misstatements and frauds not identified and found. At the same time, for the continuous audit clients, many experienced CPAs, in the case of selective implementation of audit procedures and simplification of due audit procedures due to their past audit experience, accidentally stumble, resulting in the consequences of audit failure.

In the case of Huaze Cobalt & Nickel, Ruihua found that the actual amount of notes receivable of Huaze Cobalt & Nickel was zero on the day of inventory, and that there were many transfers in and out on the books of notes receivable, and a large number of transfers in and out before the year and a large number of transfers out after the year, but it ignored the potential risk of major misstatement of Huaze cobalt & nickel. It simplifies and omits the audit procedures that should be carried out, resulting in the failure to design and carry out further audit procedures related to notes receivable.

The above shows that although CPAs have more auditing experience, they choose not to abide by auditing standards for the reasons of "saving trouble", "relaxing" and "not being found or punished for doing so before", thus showing a false lack of professional competence.

4.1.2. Loss of awareness of maintaining professional skepticism

In addition to devoting less attention and energy to a single audit business and implementing audit procedures selectively as mentioned above, many CPAs do not have due professional suspicion when they notice contradictions between financial or non-financial information, large and abnormal amounts or transactions. It is often a simple oral inquiry or to obtain some necessary information such as contracts, minutes of meetings, promises and so on, without properly taking further audit procedures, further investigation and evidence collection, which reduces the quality of audit and increases the possibility of audit failure.

In the case of Haige Logistics, when Ruihua learned that the controlling shareholder of the company was Osman Investment and assessed it as a special risk, it did not maintain due professional suspicion of its related parties and their transactions, so it did not carry out further audit procedures related to related parties and their transactions. It is not found that the relevant disclosure of Osman Investment by Hercules Logistics is insufficient, and it is not found that Osman Investment has occupied the funds of Haige Logistics.

It shows that the certified public accountants of Ruihua Institute are too credulous to trust the audited units, and do not maintain due professional suspicion for reasons such as "saving trouble", "should not be found by regulators", "it doesn't matter if no fraud is found".

4.2. Reasons for the accounting firm

4.2.1. Inadequate risk assessment

Before accepting audit services, audit institutions should carefully assess the auditees and their environment, refuse audit clients with higher risk assessment if necessary, and set a lower overall materiality level if accepting services to reduce audit risk. At the same time, it should also assess whether its own ability and understanding of the industry in which the audited unit is located are sufficient for the audit business. But in fact, for the purpose of pursuing profits, audit institutions often spontaneously lower the threshold of accepting audit business, or even "refuse all comers", which greatly increases the audit risk. What's more, some audit institutions often simplify and neglect the risk assessment procedure, which makes the risk assessment procedure lose its own role and become superficial.

In the case of Huaze Cobalt & nickel, Ruihua Institute did not correctly assess the risk of Huaze Cobalt & nickel (the ownership structure has obvious characteristics of a dominant share, the Wang family occupies 35.3% of the equity ratio, while other shareholders have a decentralized, low or even very low share ratio), simplified and neglected the risk assessment process, and not only accepted the audit. In the implementation of audit procedures, they did not maintain a high degree of vigilance and due prudence.

4.2.2. Lack of necessary quality control

The necessary quality control system can not only discover risks in advance, misstatement and fraud in the event, but also supervise and review afterwards, and "check and fill gaps", which is of obvious importance. However, even in audit institutions with three-level review procedures, there are often cases in which the first level fails to find errors, the second level passes hastily, and the third level signs directly. The neglect of quality control by accounting firms makes the audit quality supervision seriously inadequate, which is also one of the reasons for the frequent occurrence of audit failure cases.

In the case of Huaze Cobalt and Nickel, Ruihua Institute has a relatively perfect four-level review mechanism. If Ruihua Institute can strictly implement the four-level review procedure, the audit quality will be effectively guaranteed. However, the audit failure of Huaze Cobalt & nickel by Ruihua Institute proves that its four-level review mechanism exists in name only and has not been effectively implemented, which makes the audit quality of Ruihua Institute not be guaranteed.

4.3. Reasons for the audit industry environment

4.3.1. The amount and intensity of penalty are relatively small.

Compared with the high audit fees of the audited units, the illegal cost of the firms is too low (Wang Sheng, 2020). First of all, the probability of audit reports being spot-checked is relatively low. Secondly, even if there are problems in spot checks, the possibility of firms being investigated and punished is relatively small. Even if they are investigated and punished, they will not bear civil and criminal responsibilities, but will only be subject to administrative penalties such as fines and warnings. Finally, even if they are warned and fined, the amount is roughly 1-3 times the business income, which is much lower than the total annual income of the firm. From this we can see that for the purpose of receiving more business and pursuing profits, accounting firms are often not afraid to issue problematic audit reports and prepare problematic audit manuscripts in the external environment where the amount and intensity of penalties are small.

Table 4. Penalty results

Haige Logistics	Huaze cobalt and nickel	Kang Dexin
Ruihua received a warning letter and was not fined.	Huaze Cobalt and Nickel was fined 600000 yuan, and the relevant personnel were also fined.	Kang Dexin was fined 600,000 yuan, and the people involved were also fined.

Observing the punishment results of the three cases of Ruihua Institute in this article, we can find that these cases of audit failure being punished are obviously very small compared with the total number of audit business of Ruihua Institute from 2009 to 2018. This kind of illegal income is far greater than the amount of punishment, which makes the laws and regulations lose their authority and deterrence, but "encourages" many listed companies to engage in financial fraud, and "encourages" many audit institutions to neglect audit quality.

4.3.2. Industry supervision is not strict enough

In addition to the Securities Regulatory Commission, the regulatory authorities responsible for supervising the audit quality of accounting firms in China also have relevant institutions such as the CICPA and the Ministry of Finance. Although the joint supervision of multiple regulatory departments seems to realize the good wish of providing multiple guarantees for the quality of supervision, in fact, the relevant regulatory departments often lag behind in the supervision of audit reports and the identification of financial fraud.

In the case of Kangde Xin, the regulatory body has a low rate of investigation and inquiry (the sampling ratio is 4.9% and 2.2% respectively, which is lower than the 5% rate of investigation and inquiry required by the regulatory body for intermediaries), and has not carried out adequate investigati on procedures (no overseas investigation related to the new optical film that should have been carried out, and no investigation related to the new optical film). The relevant evidence is not perfect), the credibility of the investigation conclusion is low (the investigation result violates the assumption of rational economic man), and there is a suspicion of presupposition, which shows the hasty, irresponsible and deviating from the fair and just working attitude of the regulators.

4.3.3. Lack of public awareness of audit quality supervision

In fact, a considerable part of the public in China do not have the basic knowledge of auditing, accounting, finance and other related specialties, which leads to their enthusiasm for participating in and supervising the quality of audit reports, understanding the financial information behind financial reports, and exploring the authenticity of corporate financial reports. Compared with active supervision, they tend to browse all kinds of analysis articles on the Internet with low accuracy, and they also tend to think that supervising the quality of audit reports is only the responsibility of the relevant regulatory authorities.

5. Countermeasures and suggestions to prevent audit failure

5.1. Countermeasures Taken by Certified Public Accountants

As the actual executor of audit, CPA is an important part of the audit process, so it is necessary to improve the quality of audit and reduce the number of audit failures. The most important thing is to enhance the professional competence of CPAs and emphasize the importance of professional ethics and diligence.

5.1.1. Certified public accountants shall fully implement risk assessment procedures.

Risk assessment procedure is the starting point of audit, because modern audit is risk-oriented audit, so only after completing the risk assessment of the audited unit, can the next audit procedure be carried out. It can also be seen from the case that the lack of risk assessment procedures has resulted in deviations in the implementation of a series of subsequent procedures. That is to say, the quality of the risk assessment process determines the quality of the final audit opinion. Therefore, in order to improve the quality of the whole audit process, it is necessary to start with the risk assessment process. According to the above statistics, the phenomenon of inadequate implementation of risk assessment procedures ranks second, which shows that in practice, CPAs often do not attach importance to the implementation of risk assessment procedures.

In the risk assessment process, we should focus on whether the audited unit has recently experienced major economic events, such as IPO, asset restructuring or ST stage. According to statistics, most of the audit failures are caused by the occurrence of major economic events in the audited units, and after identification, these enterprises should be strictly audited.

5.1.2. The certified public accountant shall personally carry out the confirmation procedure.

From the previous analysis, we can see that the correspondence procedure is the easiest and most common audit procedure for CPAs to implement inadequately. Correspondence procedures often do not require strong professional knowledge, but need to ensure that the correspondence process is correct and the information is accurate. Therefore, CPAs should not only ensure their professional competence, but also ensure that the staff dealing with correspondence can collect and process correspondence information reasonably, ensure the validity of correspondence and ensure the quality of audit. At the same time, the lack of audit processing procedures is not independent, which may be caused by the chain effect. The failure of correspondence may lead to errors in the subsequent audit procedures. For example, in the case of Huaze Cobalt and Nickel, the incorrect implementation of correspondence procedures resulted in inappropriate implementation of procedures for fraud risk.

5.1.3. The certified public accountant shall carefully record the audit working papers.

The working paper in the audit records the whole audit process from the beginning of accepting the entrustment to the final issuance of audit opinions. Although it is generally used by the certified public accountants themselves, it is the carrier of audit evidence, records the work carried out and the information obtained in the whole audit process, and can be said to be the direct basis for auditors to form audit conclusions and issue audit opinions. When the audit process and results are questioned, the working paper is also a favorable evidence for CPAs to prove their innocence and a talisman for CPAs. Therefore, when making working papers, CPAs should ensure their accuracy and completeness, so as to facilitate their own inspection, so as to reduce some errors in audit work and ensure the quality of audit.

5.2. Countermeasures taken by the accounting firm

With the rapid development of the domestic capital market, the scale of accounting firms has been expanding, and the number of branch offices has also increased substantially, which also makes the head office and branch offices more inconsistent. In this regard, accounting firms need to strengthen management to prevent audit risks.

5.2.1. Unify and implement various systems of the accounting firm

First of all, in order to attract and retain employees, we need to develop a scientific and fair reward and punishment system. At the same time, a unified system is also needed in performance appraisal, salary and income distribution, so as to retain talents. In addition, in order to strengthen the audit quality management, it is necessary to standardize the working procedures among the headquarters and branches, and to unify the systems of administration, quality management and business management.

5.2.2. Strengthen the management and control of newly established branch offices and newly joined teams

In the initial stage of the establishment of a new team, experienced managers should be appointed by the head office to guide the work, and necessary training should be given to the new team to form standardized management. Firms should work out a reasonable and feasible integration plan after the merger, because the merging party and the merged party are different in terms of scale, human resources and customer resource management. Only in this way can the two sides of the merger run into better results and promote the healthy development of the firm as a whole. First of all, the personnel level of the general branch should be unified. In order to avoid dissatisfaction among employees, clear standards should be formulated for the qualification and promotion system at all levels, and they should be open and transparent. Secondly, in order to maintain existing customers and open up new markets, firms should strengthen the construction of internal governance mechanism, and formulate customer maintenance programs, and achieve the basic consistency between the total score and the total score. In addition, it is necessary to unify the professional spirit and business philosophy between the general branch offices. To achieve this, it is necessary for the staff of the general branch offices to rotate or second, exchange and learn from each other, and hold regular training meetings to emphasize and consolidate them.

5.3. Countermeasures taken by audit industry supervision

5.3.1. Standardize the order of the audit market and improve market access conditions

With the implementation of the new Securities Law, the audit market of listed companies in China has no restrictions on administrative licensing, and has basically been fully opened, which makes the competition in the audit market crueller, if not regulated, the disorderly competition such as low-price solicitation will be more frequent in the future. Therefore, the relevant regulatory authorities should speed up the purification of the audit environment, the rectification of the audit market and the improvement of business quality. Specifically, we can regulate the order of the audit market from three aspects.

First of all, auditors are the specific participants in the audit market, so the purification of the audit environment should start with auditors, strengthen the construction of auditors ‘professional ethics, establish a supervision mechanism of integrity culture, punish auditors' dishonest and illegal acts, and build a healthier practice environment.

Secondly, most large and medium-sized enterprises are more inclined to employ the four major international audit firms, which leads to the lack of opportunities for domestic firms to undertake large-scale projects, thus forcing domestic firms to undertake only a large number of small and medium-sized audit business with low income. Therefore, the Institute of Certified Public Accountants formulates subsidy policies to promote the development of domestic firms, and provides targeted professional education and training for domestic firms to help them strengthen their internal governance level, so as to enhance their competitiveness in the audit market and break the monopoly of foreign firms on the audit of large and medium-sized enterprises.

Finally, CPAs and accounting firms are the gatekeepers of the capital market. There are essential differences between the audit market and other markets. When the market entry barriers are low and the requirements for qualifications are not high, it will inevitably lead to more overflowing of audit opinion buying, leaving institutional loopholes for low-quality enterprises. Therefore, although there is no administrative license for securities business audit, the relevant regulatory bodies should still establish a quality-oriented market regulation mechanism to blacklist low-quality and dishonest accounting firms in the industry, so as to promote the improvement of the overall audit quality of the audit industry.

5.3.2. Strengthen administrative supervision and increase illegal cost

At present, there is a current situation of "heavy administrative punishment, light civil compensation" for the false statement of accounting firms in our country. If investors sue accounting firms for civil infringement, they must be accepted by the court after the accounting firms are punished by the administrative punishment. However, there are fewer administrative penalties for accounting firms in China every year, which leads to higher litigation costs for investors against accounting firms, lower probability of civil liability for accounting firms, and lower deterrence of legal punishment to accounting firms.

At the same time, in the case of Kang Dexin's audit failure, Zhong Yu, as the main organizer of the case, was fined only 900,000 yuan by the SFC and banned from the securities market for life. Compared with the social impact of Kang Dexin's case, the 900,000-yuan fine is obviously unreasonable. Therefore, the new Securities Law, which was formally implemented in 2021, has adjusted the penalty to be too low. When a listed company is listed fraudulently, the maximum penalty can be twice the amount raised, which is much higher than the original standard of 5% of the amount raised. In view of the A-share market with frequent false statements and false disclosures, the existing regulations have raised the penalty limit to 10 million yuan, which is much higher than the maximum penalty of 60 yuan stipulated in the original regulations. It is more suitable for the current development trend of China's capital market and is in line with the penalty standards in the international capital market, which can more effectively crack down on illegal and irregular acts in the securities market.

6. Conclusion

This paper focuses on the three audit failures of Ruihua Institute, which are Haige Logistics, Huaze Cobalt and Nickel, and Kangdesin, and explores the reasons behind their audit failures. After further research, it is found that Ruihua did not maintain due professional skepticism towards some items that may lead to material misstatements in financial statements during the audit process, and the implementation of audit procedures was not in place, resulting in a mere formality. The lack of professional competence of auditors is the direct cause of audit failure, and there have been some internal defects in Ruihua itself, such as inadequate internal quality control and low degree of integration, which are the underlying causes of audit failure. In addition, the fierce external competition induces firms to reduce audit investment in a limited time, or reduce audit quality, while external supervision is not enough to deter, which is the objective reason for audit failure. To solve the related problems based on these reasons, every individual and organization related to them should stick to their responsibilities and strive to contribute to the development of the market. CPAs should always keep alert, maintain independence, and constantly improve themselves with social changes, strive to improve their professional standards, and jointly establish a professional image worthy of social trust. Firms should also strengthen the construction of risk control system, provide training for auditors, strengthen internal business quality management, improve the organizational management system, and improve the quality of audit reports issued by the firm. Industry organizations should be more proactive to manage CPA groups, promote healthy competition within the industry, and improve the industry self-discipline mechanism. Government departments should also keep pace with the times, improve laws and regulations, update supervision measures in time, and strengthen supervision.

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