

Summary of Experience in Teaching Postgraduate Students majoring in Auditing to Learn Auditing Standard 1502

Jin Chen*

School of Accountancy, Anhui University of Finance and Economics, Bengbu 233030, China

*Corresponding Author Email: 1730607338@qq.com

ABSTRACT

In order to make the audit report more transparent in reflecting the business status of the enterprise, better serve stakeholders, and align with international standards, China has continuously improved the audit report to meet market demand. The audit report introduces non unqualified opinion audit reports from four aspects: report type, report changes, report analysis, and impact, to help report adaptors understand this type of audit report. This article mainly summarizes the experience of teaching graduate students majoring in auditing to learn auditing standard 1502, in order to enable them to learn how to issue correct non unqualified audit reports and improve their professional literacy.

KEYWORDS

Audit report; Type; Experience; Influence.

1. INTRODUCTION

In order to improve the information content of audit reports, meet the demand for high-quality accounting information in capital market reform and development, and maintain the continuous and comprehensive convergence of China's audit standards with international standards, the Ministry of Finance issued 12 Chinese Certified Public Accountant Audit Standards on December 23, 2016. The new audit reporting standards aim to improve the transparency of audit work performed by certified public accountants through communication with management and governance, promote certified public accountants to maintain higher professional skepticism, provide additional important information to financial statement users, and enhance the decision-making relevance and usefulness of audit reports.

A non unqualified opinion refers to a qualified opinion, an inability to express an opinion, and a negative opinion, all of which are considered by the auditor to be a legal and fair representation of the financial statements and should be issued with caution. The number of non unqualified opinions issued is sometimes considered a signal to improve audit quality. However, issuing audit reports with non unqualified opinions requires professional judgment and high requirements for students. Therefore, it is very important to guide students to learn how to issue non unqualified opinions, and also requires careful guidance from professors.

2. BACKGROUND OF TEACHER INTRODUCTION GUIDELINES RELEASE

On December 23, 2016, the Ministry of Finance issued a notice on 12 new audit standards, including "Chinese Certified Public Accountants Auditing Standards No. 1504- Communication of Key Audit Matters in Audit Reports", requiring the new standards to be implemented in batches and steps. For A+H-share companies and pure H-share companies that issue audit reports in accordance with Chinese Certified Public Accountants Auditing Standards, implementation will begin on January 1, 2017. Other main board companies Small and medium-sized board companies should implement the new audit reporting standards starting from January 1, 2018, while allowing and encouraging early implementation.

3. TEACHING METHODS

First, group the students and ask them to report in groups. The second group of students will report as follows:

3.1. Report type

For the audit opinion issued on financial statements, certified public accountants need to follow the requirements of audit standards, be risk oriented, control oriented, understand the audited entity and its environment, and then evaluate the risk of material misstatement. Take necessary measures to address risk points. When a misstatement has a significant but not widespread impact on the financial statements, a qualified opinion should be expressed in accordance with the requirements of auditing standards; When the misstatement is significant and widespread, a negative opinion should be issued in the audit report. If a certified public accountant is unable to obtain sufficient and appropriate audit evidence to evaluate the impact on the audit report during the audit, if the matter is significant but not extensive, a qualified opinion should be issued. If the matter is significant and extensive, an audit report that cannot express an opinion should be issued. The error margin matrix for issuing audit opinions is shown in Table 1.

Table 1. Error margin matrix for issuing audit opinions

The nature of matters that result in non unqualified opinions	The extent to which these matters have or may have an impact on the financial statements	
	Significant but not widespread	Significant and extensive
There are significant misstatements in the financial statements	Reserved opinion	Negative opinion
Inability to obtain sufficient and appropriate audit evidence	Reserved opinion	Unable to express opinions

According to auditing standards, significant misstatement in financial statements refers to the selection of inappropriate accounting policies or the failure to properly apply accounting policies, or the failure to properly present and disclose the basis of financial reporting used.

According to auditing standards, the term "inability to express an opinion" refers to situations beyond the control of the audited entity or related to the nature or timing of the work of a certified public accountant, or situations where management imposes restrictions that prevent the certified public accountant from obtaining sufficient and appropriate audit evidence to express an audit opinion.

Table 2. Significant errors in financial statements

Case	Explanation
Appropriateness of selected accounting policies	(1) The selected accounting policy is inconsistent with the applicable basis for preparing financial reports; (2) The financial statements (including relevant notes) do not reflect transactions and events in a fair presentation manner.
Application of selected accounting policies	(1) Inconsistent use; (2) Improper use.
Appropriateness or adequacy of financial statement disclosures	(1) The financial statements do not include all disclosures required for the preparation of applicable financial reports; (2) The disclosure of financial statements is not presented in accordance with the applicable financial reporting basis; (3) The financial statements did not make necessary disclosures to achieve a fair presentation.

Table 3. Unable to express opinions

Case	Explanation
Situations beyond the control of the audited entity	(1) The accounting records of the audited entity have been destroyed; (2) The accounting records of important components have been indefinitely sealed by relevant government agencies.
Situations related to the nature or timing of the work of a certified public accountant	(1) Certified public accountants are unable to obtain sufficient and appropriate audit evidence regarding the financial information of joint ventures to evaluate whether the equity method has been appropriately applied; (2) Certified public accountants are unable to implement inventory monitoring; (3) Certified public accountants determine that only substantive procedures are insufficient, but the control of the audited entity is ineffective.
Situations where management imposes restrictions	(1) Management prevents registered accountants from implementing inventory monitoring; (2) The management prevents registered accountants from issuing letters of confirmation on specific account balances.

The auditing standards provide two "degree" analyses of the matters that affect the financial statements, namely, materiality and breadth, to determine the extent to which the matters affect the financial statements. Extensiveness is deeper and wider in scope compared to significance, and it is usually difficult to determine the degree of impact on a single project. For example, a misstatement involving a small amount of money may not exceed the level of importance recognized, but it can turn a company from loss to profit, affecting the understanding of financial statements by statement users. We believe that this misstatement is significant and widespread.

Table 4. Impact of audit standards on matters affecting financial statements

Matter	Explanation
Major	(1) There are significant misstatements in the financial statements; (2) Unable to obtain sufficient and appropriate audit evidence as the basis for forming an audit opinion, but deemed that undiscovered misstatements (if any) may have a significant impact on the financial statements. (3) Usually, the potential impact of misstatements or audit scope limitations that reach or exceed the overall level of materiality in the financial statements is considered significant.
Extensiveness	(1) Not limited to having an impact on specific elements, accounts, or items of financial statements; (2) Although it only affects specific elements, accounts, or items of the financial statements, these elements, accounts, or items are or may be the main components of the financial statements; (3) When it comes to disclosure, the impact it generates is crucial for financial statement users to understand financial statements.

3.2. Report Example

3.2.1. Reservation of opinions

On June 28th, Jiebao Machinery (837627) released its 2016 annual report. According to the announcement, the company achieved a revenue of 68.702 million yuan in 2016, an increase of 4.88% compared to the same period last year. The main reason for the growth is the acquisition of 100% equity of Wenling Xinyue Trading Co., Ltd. on June 29, 2016, and its inclusion in the merger scope after the acquisition. Realized a net profit of 3.086 million yuan, a decrease rate of 91.51% compared to the same period last year. Mainly due to the increase in prices of raw materials such as steel plates, enameled wires, and castings, resulting in a decrease in gross profit, as well as the internal payment of various intermediary fees for listing.

It is worth noting that the audit report issued by the certified public accountant this time is with a qualified opinion. The specific content of the reserved items is: in 2016, Jiebao Company signed an "Equipment Procurement Contract" with the Feixing Machinery and Equipment Business Department of Pengze County. According to the contract, Jiebao Company purchased machinery and equipment from the business department, with a total contract price of 100 million yuan. Jiebao Company made a prepayment of 60 million yuan to the operating department in September 2016 as agreed in the contract. As of December 31, 2016, the balance of the prepayment of 60 million yuan was reported in the "Other Non Current Assets" section of Jiebao Company's balance sheet.

The certified public accountant believes that satisfactory audit procedures cannot be implemented for this matter, and sufficient and appropriate audit evidence can be obtained regarding the authenticity of the transaction and whether there is a related relationship between Jiebao Company and the operating department. An audit report that expresses a qualified opinion due to the significant but not widespread nature of the matter.

3.2.2. Unable to express opinions

This article takes a construction company that issues an audit report in accordance with the 2017 salary standards as an example. Ruihua Certified Public Accountants has been commissioned to audit the 2016 annual report of ST Kunji. Due to the involvement of inventory matters, sales revenue matters, matters related to important subsidiaries, and the inability to obtain sufficient and appropriate audit evidence for the investigation of the China Securities Regulatory Commission to determine its impact on the financial statements, an audit report that cannot express an opinion has been issued.

3.2.3. Negative opinions

In recent years, there have been no companies in the capital market that have issued negative audit reports. However, based on relevant information, we found that although this company was issued an audit report by the auditor that could not express an opinion, it still cannot escape administrative penalties from the China Securities Regulatory Commission. Such incidents have also occurred in the capital market, but the attitude of the China Securities Regulatory Commission at that time was to recognize the behavior of the accounting firm. Today, we can see that the Chinese capital market is constantly improving, and the regulatory efforts of the China Securities Regulatory Commission are also increasing. Worth gratification!

In my personal opinion, what kind of opinion to issue is a formality, whether it is a qualified opinion, a negative opinion, or an inability to express an opinion, it is only a formality. The opinion basis for issuing an audit opinion is the core. The following example is given - Yinji Carbon New Materials Co., Ltd. In the 2015 audit report, an inability to express an opinion was issued, which on the surface can reflect the firm's professionalism and responsibility. After all, an inability to express an opinion has already been issued. However, Upon closer examination, it is not difficult to find that the third issue of the basis for issuing an opinion that cannot be expressed has nothing to do with the content stated in the 2017 error correction report regarding external investment matters. In a sense, although the accounting firm issued an opinion that cannot be expressed, its behavior is actually providing cover for the audited unit, and the disclosed audit opinion basis does not involve the core of the event at all. Therefore, I believe that a negative opinion should be expressed on the financial statements of this company based on this matter, stating that the investment matter is a fictitious matter. If the profits related to this matter are stripped off, the company will incur losses for two years, which will have a broad impact on the understanding of financial statements by users of financial statements.

On February 14, 2017, Yang Gaoyu and Wei Lihong, registered accountants of Beijing Zhongzheng Tiantong Certified Public Accountants (Special General Partnership), received a regulatory letter from the Company Management Department of Shenzhen Stock Exchange due to the illegality of the above-mentioned matters.

3.3. Analysis of the report

3.3.1. Basic information of audit opinion

Starting from January 1, 2017, mainland China entered the first stage of implementing new audit reports. During the first reporting period under the new audit reporting system, a total of 119 new audit reports were issued. Specifically, it includes:

- (1) 95 A+H share companies. In mainland China, 90 of the above-mentioned companies are listed on the main board and 5 are listed on the SME board
- (2) 20 pure H-share companies and choose to issue audit reports in accordance with the Chinese Certified Public Accountants Auditing Standards;
- (3) Four mainland Chinese companies voluntarily adopt new audit reports in advance.

For A+H-share companies, 93 audit reports issued unqualified opinions, 1 audit report included an emphasis section, and 1 audit report could not express an opinion; In the new audit reports that have been issued, there are two reports that involve significant uncertainty in the disclosure of continuing operations, namely Shandong Molong, *ST Kunji, Shandong Molong, and Chongqing Iron and Steel.

Table 5. Basic information of audit opinions

Company Name	Audit opinion
Shandong Molong	The audit report includes an emphasis section, emphasizing that the matter is a case investigation initiated by the China Securities Regulatory Commission
*ST Kunji	Audit report that cannot express an opinion
Shandong Molong	Disclosures involving significant uncertainties related to going concern
Chongqing Iron and Steel	Disclosures involving significant uncertainties related to going concern

3.3.2. Overview of Enterprises Adopting New Standards

As of April 30, 2017, 3050 listed companies and 20 pure H-shares in the Shanghai and Shenzhen stock markets have all disclosed their annual audit reports on time (except for * ST Rare Carbon). Among the 3070 audit reports, there were a total of 106 non-standard opinions, accounting for 3.5%.

There are a total of 31 non unqualified audit reports, of which 21 have qualified opinions, 10 cannot express opinions, and the rest are audit reports with emphasized matters, totaling 75. From the content of the audit opinion, there were a total of 71 non-standard opinions in the 2016 audit report, resulting in the issuance of non-standard opinions as shown in the figure. Among them, there are a total of 53 companies with significant uncertainty in their ability to continue operating, 16 companies with significant uncertainty in their litigation results, 25 companies with significant uncertainty in their inspection results filed by the China Securities Regulatory Commission, and 46 companies unable to obtain audit evidence.

3.3.3. Analysis of retained opinions

In 2016, a total of 21 companies were issued qualified audit reports, involving 34 non-standard matters. As shown in the table below:

Table 6. Audit status of qualified opinions

Non standard matters	Number
Inability to obtain sufficient and appropriate audit evidence	25
There is significant uncertainty in the outcome of the lawsuit	4
other	5

Among the 25 non-standard events, 15 were in the asset category, mainly including the inability to obtain sufficient and appropriate evidence for significant accounts receivable and significant inventory; Significant long-term assets cannot obtain sufficient and appropriate evidence. Among other non-standard matters, two are related to liability accounts, one is related to prior period errors, four are related to significant transactions, and three are related to related party transactions.

3.3.4. Unable to express opinions Content analysis

There have been no non unqualified audit reports for the supply industry, health and social work, as well as scientific research and technological services industry this year. High risk companies have a relatively large proportion of non unqualified audit reports. The profitability situation is poor, and there is an urgent need to turn losses into profits. Radical accounting policies are often adopted to

increase profits, achieve earnings management, or meet investor expectations. This type of company has a significantly higher proportion of non-standard opinions than other companies. In 2016, 46 ST companies were issued non-standard reports, accounting for 43.4%, an increase of 4.6% from the previous year. On the other hand, ST companies that receive non-standard reports also account for 58.2% of all ST companies. The overall trend of the proportion of non-standard reports issued by audit institutions to the number of listed companies audited is the same. There is a positive correlation between non-standard reports and the disclosure time of annual reports of listed companies, with 72.6% of non-standard reports disclosed in April 2017

4. TEACHER SUMMARY

The impact of audit reports: The type of audit opinion issued has a broad impact on the survival and development of enterprises. Many companies even have cases of purchasing audit opinions.

(1) Restructuring is hindered. Listed companies will lose their qualifications for public issuance, rights issues, and issuance of convertible bonds. According to the Measures for the Administration of Securities Issuance by Listed Companies in China, the financial statements of the past three years and one period have not been audited by a certified public accountant with a qualified opinion, negative opinion, or inability to express an opinion; If a certified public accountant issues an unqualified audit report with an emphasis on certain matters, the company shall not publicly issue securities if the matters involved have no significant adverse effects on the issuer or if the significant adverse effects have been eliminated before the issuance; The financial statements of the past year and the previous period have been audited by a certified public accountant with a qualified opinion, a negative opinion, or an opinion that cannot be expressed. No public issuance of stocks is allowed.

(2) Exclusion of constituent stocks. Due to some investment funds linking their stock selection range to index constituent stocks, once listed companies are excluded from constituent stocks, it will inevitably lead to institutional investors selling stocks on a large scale, resulting in a sharp drop in stock prices.

(3) Equity incentives cannot be implemented. Most listed companies, when implementing equity incentives, use an audit report from an accounting firm that provides a standard opinion on the financial statements as a prerequisite. Article 7 of the Measures for the Administration of Equity Incentives of Listed Companies: If a listed company falls under any of the following circumstances, it shall not implement equity incentives: the financial accounting report of the most recent accounting year has been issued by a registered accountant with a negative opinion or an audit report that cannot express an opinion; The internal control of the financial report for the most recent fiscal year has been audited by a certified public accountant with a negative opinion or an opinion that cannot be expressed.

(4) Additional consideration for stock reform. During the stock reform of listed companies, some companies have proposed that if the financial statements of the listed company are audited with non-standard opinions, the original non circulating shareholders will send stocks to the circulating shareholders.

REFERENCES

- [1] Kan Jinghua. The characteristics and inspirations of the reform of the audit report model of the International Audit and Assurance Standards Board [J]. Journal of Nanjing Audit University. 2017 (02).
- [2] Zuo Rui, Wen Jing, Liu Shaofeng. Research on the Implementation of China's New Audit Reporting Standards: Data Analysis Based on the 2016 Annual Audit Report [J]. Certified Public Accountant, 2017 (14).
- [3] Tang Jianhua. Analysis of the Reform of Audit Reports by the International Audit and Assurance Standards Board [J]. Audit Research, 2015 (01).