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Research on the Control of Audit Risk of Asset Reorganization

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Abstract: *The risk of asset reorganization audit refers to the possibility of the failure of asset reorganization or the decision failure of information users caused by the auditors' inappropriate audit opinions on the financial statements of the underlying assets. It has the characteristics of universality, complexity and dynamics. This paper argues that the main causes of the audit risk of asset restructuring are the opportunistic behavior of asset restructuring, the high uncertainty of profit forecast report, the incomplete and unreliable non-accounting information disclosure and the lack of professional competence and professional ethics of auditors. Considering the institutional environment in China, it is considered that the joint efforts of accounting firms, relevant accounting policy formulation agencies and regulatory agencies are needed to effectively reduce the audit risk of asset restructuring. Among them, auditors should make clear the importance of strategic analysis, and on this basis, determine the audit focus according to the value driving factors and key operational risks, and at the same time emphasize the importance of the auditor's industry expertise and professional ethics construction.*

Keywords: *Asset restructuring, Audit risk, Econometric model, Modern risk-oriented audit*

1. Introduction

The motivation and performance of asset restructuring has always been a hot topic in academic research. It can be said that the motivation and performance research is discussed from both sides of the direct transaction of asset restructuring. However, we must pay attention to the third party in the capital market--the existence of auditors as information intermediaries. It can be considered that asset reorganization is a contract based on accounting information transaction. Both parties of asset reorganization transaction decide whether to carry out asset reorganization transaction and transaction price decision through accounting information. Therefore, the quality of accounting information of the underlying asset is crucial. Auditors' verification of the underlying assets' financial statement information and their audit opinions on whether it is true and fair can reduce the transaction costs of both sides of the asset restructuring transaction, improve the benefits of asset restructuring and promote the effective allocation of capital market resources. Of course, the auditors are also responsible. Asset restructuring involves multi-party relationship transaction and multi-interest game. How to deal with the audit risk of asset restructuring and how to improve the audit quality according to the audit demand of the current market is the focus of this paper.

2. The Connotation and Measurement Model of Assets Restructuring Audit Risk

2.1. The Meaning of Assets Reorganization Audit Risk

Audit risk refers to the risk of administrative liability, civil liability and criminal liability that may be caused by the auditors' improper audit opinions on the fairness of the financial statements after the audit of the financial statements of enterprises. It is necessary to analyze the audit risk of asset reorganization from the perspective of audit demand and supply. Asset reorganization mainly includes equity transfer, acquisition and merger, asset divestiture and asset replacement. Not only the two sides of the transaction have audit needs, but also the capital market has certain audit expectations as asset restructuring transaction involves optimization of resource allocation. Audit responsibility is closely related to audit risk, and the investigation of audit responsibility is the social reason that leads to audit risk. Assets reorganization of both parties and the whole capital market requires the auditor to the financial statements of the underlying assets to be purchased information are true and fair to reflect the

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enterprise to express an opinion, economic substance expectations with high quality accounting information to reduce the contracting parties of the transaction cost, thus improve the decision efficiency (transaction cost mainly for measuring costs here, Refers to the post-audit accounting information reduces the degree of information asymmetry between the two parties, and at the same time reduces the subsequent asset evaluation cost and negotiation game cost). This paper holds that the risk of asset reorganization audit is the possibility of the failure of asset reorganization or the decision failure of information users caused by the inappropriate audit opinions on the underlying asset financial statements. [1]

2.2. Characteristics of Assets Reorganization Audit Risk

(1) Universal asset restructuring is a major decision based on the enterprise environment and development strategy, with high environmental sensitivity. Various factors such as macro-political and economic environment, industry environment and stakeholders are highly uncertain. Changes of any environmental factors or other unpredicted factors may affect each other or have a cumulative impact, leading to the failure of asset restructuring. It can be seen that the inherent risk of asset restructuring audit is very high, and the uncontrollable factors greatly increase the risk of asset restructuring audit. In addition, in the asset reorganization audit, the management has a very high contract motivation and government supervision motivation to prepare false financial reports for financial fraud. The motivation is embodied in the management of the underlying asset to increase the transaction price or obtain other favorable contract terms to inflate income and manipulate profits, and the actual controller to hide the fact of profit transmission through asset restructuring through the approval of the CSRC. Financial fraud is usually related to the management's overcontrol, which has a high risk of material misstatement at the financial statement level and a high potential risk in audit. [2]

(2) Complex asset restructuring involves more related party transactions, and complex related party transactions and multi-party interest games increase the difficulty and risk of audit. Related party transactions because of its extensive and complex relationship and organizational structure characteristics has been the audit focus areas, how to identify and assess potential in assets reorganization of related party relationships to maintain prudent professional doubt auditors, at the same time to have the actual control of dominant influence interest conveying information or matters to be vigilant. A large number of asset restructuring transactions are mainly for the purpose of restructuring and improving independence. The disclosed related party relationship makes auditors pay attention to it and collect relevant audit evidence for support during the audit planning and implementation stage, which may not have higher audit risks. In contrast, auditors need to pay more attention to the undisclosed related parties, especially the actual controllers of enterprise groups. If there is an undisclosed related party, the asset restructuring may be a tunneling or support behavior manipulated by the actual controller to transfer benefits, which may be suspected of internal illegal transactions. However, it is complicated to judge whether there is a potential related party relationship and whether the asset restructuring has commercial essence. In order to achieve the purpose of enterprise structure optimization and operation coordination, asset reorganization has certain requirements on the long-term value and future development ability of the underlying assets, which often involves profit forecast report and performance commitment compensation. To judge the value of the underlying assets, the future sustainable operation ability and the rationality and realization of the earnings forecast report, the auditors need to calculate the future expectations according to the operating history of the underlying assets. Therefore, audit complexity and risk are high.

(3) Dynamic asset restructuring needs to go through multiple stages such as planning decision, strategy implementation and CSRC approval, and each stage has different requirements for auditors. In the decision stage of asset restructuring plan, auditors should focus on due diligence, pay attention to the going concern ability and value of the underlying assets, and whether there is a hidden related party relationship between the two parties of the asset restructuring transaction; In the implementation stage of the reorganization, it is necessary to carry out special audit on the financial statements of the underlying assets, and verify whether the accounting information is true and fair. On the one hand, it provides a basis for asset evaluation, and on the other hand, it supports the judgment and decision of the whole process of asset reorganization. If the earnings forecast report is involved, the reliability of the earnings forecast report should be audited. It can be seen that the audit content of asset reorganization in different stages is different, which requires continuous attention of auditors to identify and evaluate potential audit risks in a timely manner. [3]

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2.3. Measurement Model of Asset Reorganization Audit Risk

According to modern risk-oriented audit model, audit risk mainly consists of financial statement material misstatement risk and inspection risk. The measurement model of the audit risk of asset reorganization can be expressed as follows: Expected audit risk (EAR) of asset reorganization = risk of material misstatement (ROSM) × risk of inspection (DR) Under the established level of audit risk, the acceptable inspection risk is inversely related to the risk of material misstatement of financial statements. The risk of material misstatement of asset reorganization is related to both parties of the asset reorganization transaction and exists independently of the asset reorganization audit. Auditors need to reduce the inspection risk by designing and implementing effective audit procedures to reduce the audit risk to an acceptable and reasonable level. Allowable Risk Level (ADR) = Expected Audit Risk (EAR)/Risk of material misstatement (ROSM).

3. Analysis of Causes of Audit Risk of Asset Reorganization

The basic mode of audit risk is composed of two aspects: the subject and the object of audit activities. The causes of audit risk of asset reorganization should also be analyzed from two aspects: the parties of asset reorganization transaction and the auditors. The audit object of asset reorganization is mainly the underlying assets, but considering that the transaction of asset reorganization may involve related party transactions and profit transmission and other issues, which may constitute the risk of material misstatement, it is necessary to include the asset buyer in the audit object.

3.1. Reasons of Both Parties in Asset Restructuring Transaction

(1) Opportunistic Asset Restructuring Behaviors At present, there are a lot of "opportunistic" behaviors in asset restructuring in China. China's asset restructuring behavior should take into account the special institutional environment of China's capital market. Opportunistic asset restructuring in the strong government intervention and legal control environment generally has the following two purposes: The first is the use of asset restructuring earnings management, that is, through asset restructuring will be inferior assets, poorly operated loss-making business and related costs, expenses and debts to the parent company or other associated enterprises, and then through accounting adjustment to turn losses into profits. Earnings management is mainly motivated by government regulation, such as preventing delisting and meeting the requirements of rights issue. Second, the actual controller of the enterprise group transfers the assets of the assets reorganization to transfer the benefits. This paper holds that the m&a behavior of listed companies is related and has the same attribute, and proposes the tunneling and support theory. A large number of scholars have also found that the controlling shareholders will use asset reorganization and other related transactions to transfer corporate resources to occupy the interests of minority shareholders. [4]

Whether the asset reorganization transaction has commercial substance is very important. "Measures for the Management of Material Assets Reorganization of Listed Companies (2016 Revision)" stipulates that the asset reorganization should be conducive to the formation or maintenance of a sound and effective corporate governance structure, and there is no harm to the legitimate rights and interests of listed companies and shareholders. If the asset reorganization obviously does not conform to commercial logic or violates the requirements of laws and regulations, there may be problems in the authenticity and legal compliance of the asset reorganization, which will bring the risk of material misstatement to the statement layer and the identification layer.

(2) the height of the profit forecast report and future performance promise uncertainty asset restructuring in the audit in addition to pay attention to whether there is any accrual accounting profit manipulation of earnings management transactions or events, such as asset impairment and depreciation does not conform to the actual, empty hang non-performing assets such as accounts receivable and underestimate estimated debts misstatement risk, also should notice another audit risk of infections, That is, earnings forecast reports and future performance compensation commitments. Performance compensation commitment is a kind of betting agreement in nature, and it has positive promotion effect on performance commitment according to signal hypothesis and incentive effect hypothesis. Some believe that performance commitment leads to high premium, but damages the interests of minority shareholders. In the stage of asset restructuring and integration, to achieve agreed performance will also become a new motivation for earnings management of listed companies. For auditors, the profit forecast report, on the one hand, is based on the judgment of the future value of the

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underlying assets and operating risks based on historical data, while the prediction of the future macro environment, industry environment, business development and risks of the enterprise itself is complex and highly uncertain, and the possibility of material misstatement risk is high. On the other hand, the accounting signal released through the earnings forecast report and future performance promise will directly affect the transaction pricing. Unreasonable high pricing will lead to the mistake of the buyer's decision, and even the large amount of goodwill will affect the enterprise value in the later period.

(3) Quality problems of non-accounting information disclosure Asset reorganization audit mainly reduces the information asymmetry and transaction costs of both parties by auditing the financial statements of the underlying assets. Due to limited by complex economic activities and accounting standard for business enterprises defects, and in some cases, the accounting information may not be able to express all the important information or restricted by the existing accounting standards cannot be true, fair performance of enterprise economic substance, rather than the disclosure of accounting information can provide more decision-making useful information, make up the lack of accounting information, improve the reliability and relevance of financial statements information. Notes to financial statements disclosed on business strategy and performance, accounting policies and accounting estimates based on the assumption of logic, the nature of the assets and the ownership and whether there might be forced out of business, administrative penalty and other potential legal risk and management risk, etc will provide supplementary evidence or information, help auditors to judge real economic conditions and the asset, the profit forecast in the future. However, at present, the quality of the disclosure of the notes to financial statements in China is uneven, and the disclosure is incomplete and unreliable, which cannot provide relevant useful information. Moreover, the existing or potential legal risks and tax risks of asset ownership are often matters that the management is easy to conceal, and there is a risk that the management is above the internal control.

3.2. Auditors Lack Professional Competence and Professional Ethics

The inspection risk depends on the reasonableness of the audit program design and the effectiveness of its implementation by the auditor. As long as auditors comply with the requirements of auditing standards and fully consider the needs of the society, there is generally no audit risk. However, if the auditors give in to the temptation of economic interests and other factors, and do not practice strictly according to the requirements of audit standards, it will lead to higher inspection risk.In asset reorganization audit, on the one hand, due to the complexity and high risk of asset reorganization audit, it is especially necessary for auditors to have professional competence and maintain prudent professional doubts. Once unqualified auditors are assigned to conduct the audit, if they have insufficient understanding of the environment of both sides of the asset restructuring transaction and are unable to make a correct judgment on the value of the underlying assets and key risks, the risk of audit failure may be caused by the deviation in the setting of audit materialization, the improper allocation of audit resources and the improper design and implementation of audit procedures, on the other hand, considering the higher asset restructuring audit fees as well as our country accounting firm competition pattern, the auditor as a rational economic man, the audit of assets restructuring to make the auditor to succumb to the economic interests, or to obtain high reputation in the field of asset restructuring audit and loss of independence, issue false audit reports.

4. Control Countermeasures for Audit Risks of Asset Reorganization

The audit risk of asset restructuring is a liability risk proposed from the perspective of auditors. Considering that China's asset restructuring is greatly affected by the institutional environment, and the audit risk of asset restructuring itself is closely related to auditors, financial statement standards and regulatory agencies, this paper intends to base itself on the perspective of capital market. From the accounting firm audit countermeasures, accounting standards based on accounting information and the coordination of regulatory behavior of the CSRC to explore the assets reorganization audit risk control countermeasures.

4.1. On the Basis of Strategic Analysis, Determine the Audit Focus According to Value Drivers and Key Operational Risks

Asset reorganization is an important strategic decision for enterprises, which requires auditors to set up strategic and system views and use modern risk-oriented audit model to guide the audit process. Since the key of asset restructuring business lies in the rationality of value valuation, and true and fair

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accounting information can reduce transaction costs, auditors need to improve the quality of accounting information in asset restructuring audit, so that it can reflect the enterprise value in a true and fair way to improve decision-making economy. The audit of asset reorganization should focus on the relevant matters and transactions that have a significant impact on the value of the enterprise, namely, value drivers and key operational risks. Based on an understanding of the strategy of the auditee and its environment, the auditor should identify value drivers and key operational risks through value chain analysis to determine the audit focus area. The determination of the audit focus not only considers the time cost limit, but also the analysis of the key factors that affect the enterprise value based on the strategic analysis helps the auditors to identify the high-risk audit areas, improve the audit efficiency and reduce the risk of audit responsibility.

Because the strategy is the enterprise planning, long-term and overall decision-making and action mode, has certain instructive for the future, so is based on the analysis of the strategic value driving factors and key operational risks identified and conducive to the auditor audit direction and key of the existence of high degree of uncertainty accounting estimates, the rationality of the surplus forecast has a more clear understanding, Auditors can adopt corresponding audit procedures to obtain more reliable and persuasive audit evidence to reduce audit risks. [5]

4.2. Strengthen the Professional Expertise of Auditors and Strengthen the Construction of Professional Ethics

Audit quality is a combination of independence and expertise. Due to the complexity, universality and dynamic characteristics of asset reorganization audit risk, auditors need to have certain professional competence. Asset restructuring, whether expansion m&a or contraction stripping, involves organizational boundary adjustment, so this paper emphasizes the role of auditors' industry expertise. Industry expertise is the auditor the important of core competitiveness, only has the capability of industry expertise, auditors can only according to the understanding of asset restructuring industry environment, analysis of trade on both sides of the supply chain and value chain, in order to clear the value of the asset, key areas, whether or not can also be used for asset restructuring deal is commercial in nature have a more accurate judgment. When the auditor's independence is weakened, even with high professional audit skills, it is difficult to achieve high audit quality.Asset restructuring is an important strategic decision for enterprises, which may result in the purchase of audit opinions. Therefore, it is necessary to focus on the independence of auditors and the construction of professional ethics. Auditors must be aware of the importance of the information they provide as information intermediaries to both sides of the transaction and to the allocation of resources in the capital market. Auditors should maintain prudent professional suspicion for high-risk assets reorganization audit; At the same time, independence should be maintained, professional ethics and social responsibility should be established, and high-quality, authentic and reliable information resources should be provided to the capital market.

4.3. Improve Related Assets Reorganization Accounting Standards, Emphasizing the Reliability and Relevance of Non-Accounting Information Disclosure

The audit object information is the financial statement, and the financial statement preparation based on the accounting standard itself may have inherent defects, so it is necessary for us to discuss the assets reorganization accounting standard. In recent years the outbreak of goodwill black swan event has aroused academic and practical circles of goodwill impairment or cumulative amortization debate. This is precisely the deviation of the judgment of the underlying asset value and the high estimate of earnings forecast and performance commitment caused by the earlier asset restructuring.

The composition of goodwill should be "cleaned up" to eliminate the valuation deviation and the loss of overconfidence of management caused by agency problems, so as to make goodwill more relevant and reliable. In addition, the asset reorganization audit should focus on the information related to the value of the underlying assets and the ability to go on operation, while the accounting information in the financial statements is limited or cannot fully reflect the true economic benefits and future development ability of the enterprise. At this time, the notes to the financial statements are particularly important. This paper suggests strengthening the institutional requirements of non-accounting information disclosure, such as notes to financial statements, and clarifying the role of notes and their importance to enterprise value disclosure.

By standardizing the disclosure of the content of the notes, the accounting information really play a

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complementary role in supporting. For example, the assumptions of the management to choose accounting policies and accounting estimates and the explanations of the management based on logic, performance and operational risk analysis, as well as the existence or potential legal proceedings, administrative penalties and tax risks of the underlying assets. Such non-accounting information is critical to asset values and critical risk judgments. Only by means of mandatory standards and standards, principle oriented provisions and standardized compulsory requirements for the notes to financial statements can management pay attention to them, thereby increasing the information content and correspondingly reducing the audit cost and liability risk of auditors.

4.4. Strengthen the Efficiency of Supervision and Implementation and Improve the Cost of Illegal Audit

The effective implementation of the rule of law is more important than the letter of the law in promoting financial development, especially in countries in transition. In China's securities market, the government plays a leading role in the allocation of resources. As an information intermediary, audit needs the government to strengthen law enforcement and regulate, and improve the efficiency of resource allocation in the capital market by enhancing the authenticity and reliability of information. The asymmetry between the cost and benefit of audit violation makes auditors succumb to economic interests and lose their independence, leading to audit failure. China Securities Regulatory Commission (CSRC) should strengthen the verification of asset restructuring business, and increase the punishment for violations of laws and regulations to serve as a warning and deterrence. For the problems that are difficult to investigate and collect evidence, experts should be used to comprehensively guide and participate in the verification process, and the asset reorganization audit business should be standardized and guided from the perspective of administrative law enforcement.

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