

Governance of Accounting Firms and Risk Management Strategies for Large Real-Estate Companies

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Abstract: *This paper examines the Evergrande debt crisis and PwC's audit failure to explore how excessive leverage, tightened regulation, poor cash flow management, and governance deficiencies combined to trigger systemic risks. The study traces the progression of Evergrande's crisis since the introduction of the "three red lines" policy, from liquidity shortages and debt defaults to large-scale homebuyer protests, highlighting the fragile financing model and complex debt structure underlying the crisis. It also analyzes PwC's audit failures in Evergrande's financial fraud, the penalties imposed, and compares them with international cases to reveal the profound consequences of weakened audit independence and internal governance imbalances. Based on these findings, the paper proposes preventive strategies: real estate firms should optimize capital structures, strengthen cash flow management, improve governance transparency, and enhance policy adaptability; accounting firms should establish mechanisms to safeguard audit independence, form specialized industry audit teams, and improve internal risk control and quality management. The conclusions provide practical insights not only for preventing debt risks in real estate enterprises but also for promoting standardized and sustainable development of the auditing profession.*

Keywords: *Evergrande Debt Crisis; Pwc; Financial Fraud; Audit Failure; Real Estate Risk Management; Audit Independence*

1. Background Analysis of the PwC–Evergrande Incident

1.1 Background Analysis of the Evergrande Incident

In August 2020, to curb the real estate bubble, the People's Bank of China and the Ministry of Housing and Urban-Rural Development introduced a three-tier regulatory framework for major developers, widely known as the "three red lines." Designed to restrict excessive leverage and prevent systemic risk, the policy immediately constrained Evergrande, which breached all three thresholds. Unable to refinance debt, its liquidity tightened sharply, pushing the company toward financial distress. From that point, negative media coverage intensified concerns about Evergrande's high leverage and complex financing structure, fueling market panic and deepening doubts over its repayment capacity. As a result, its stock price fluctuated drastically, and its debt crisis worsened^[1].

Evergrande attempted to secure an A-share listing through a backdoor merger with Shenzhen Special Economic Zone Real Estate & Properties, aiming to raise capital and improve its image. However, repeated delays led to the plan's termination in 2021, further eroding investor confidence. Starting mid-2021, rating agencies including Moody's, S&P, Fitch, and China Chengxin International downgraded Evergrande to "junk" status, driving up financing costs and worsening its liquidity strain. In July, China Guangfa Bank sought to freeze Evergrande's assets through litigation, signaling the collapse of its financial support network^[2].

On August 19, 2021, Evergrande was summoned by the central bank and the CBIRC to address its debt risks and protect creditor rights. Yet, this intervention failed to alleviate the crisis. On September 8, a bank run at Evergrande Wealth, its financial subsidiary, triggered widespread panic as redemption requests went unmet, leading to a complete collapse of market trust.

The Evergrande crisis stemmed from a combination of high leverage, regulatory tightening, weak governance, and adverse external shocks. From the enforcement of the "three red lines" to failed financing attempts and successive credit downgrades, its problems became irreversible, ultimately

erupting into a full-scale debt default^[1].

1.2 PwC's Audit Controversy

In 2023, Evergrande announced progress in its debt restructuring, emphasizing the importance of completing the 2021 audited financial statements. However, PwC identified issues related to the going-concern basis and asset impairment assessment, requiring additional procedures and time. As the parties failed to reach an agreement on scope and timeline, Evergrande's board dismissed PwC and appointed another audit firm.

In its resignation letter, PwC noted that it had not received critical information from Evergrande, including reports on off-balance-sheet wealth products, liabilities, and pledged deposits, which were necessary for independent investigation. Consequently, PwC was unable to issue an audit opinion on Evergrande's 2021 financial statements^[3].

Subsequent reports issued by Lixin Certified Public Accountants revealed that Evergrande's total liabilities reached RMB 24.37 trillion, with net losses exceeding RMB 800 billion for two consecutive years. The China Securities Regulatory Commission's investigation further found that Evergrande had inflated revenue and profits in 2019 and 2020. PwC failed to detect this large-scale financial fraud, leading to erroneous audit opinions. PwC's shortcomings played a significant role in the scandal, highlighting serious deficiencies in its audit practices^[4].

2. Analysis and Countermeasures for the Evergrande Debt Crisis

2.1 Structural Analysis of Evergrande's Debt

As of December 31, 2022, China Evergrande's total liabilities amounted to RMB 2.44 trillion. By the end of 2022, the composition of these liabilities included RMB 721 billion in contract liabilities, RMB 612.4 billion in borrowings, RMB 1.0023 trillion in trade payables and other payables, and RMB 101.7 billion in other liabilities. Within the category of trade payables and other payables, payments owed for construction and materials accounted for RMB 596.2 billion.

Of Evergrande's RMB 2.44 trillion in total liabilities, more than RMB 600 billion corresponded to obligations to homebuyers awaiting delivery of pre-sold properties. These liabilities are directly linked to the government's policy mandate of "ensuring housing delivery" (bao jiaolou), which requires developers to prioritize project completion. The remaining RMB 1.8 trillion in debt originated from three main sources. The first consisted of land acquisition costs, which largely represented revenues of local governments under the land finance system. The second comprised accumulated interest on land purchase loans, which translated into high-yield profits for financial institutions. The third consisted of overdue construction and material payments owed to suppliers and contractors^[1].

In addition, Evergrande's wealth management arm had outstanding, unpaid investment products amounting to approximately RMB 40 billion. By the end of 2022, the overdue amount of commercial acceptance bills (neidi shangpiao) issued by Evergrande had reached RMB 326.3 billion, constituting a substantial portion of its trade and other payables.

2.2 Causes of Evergrande's Debt Problems

2.2.1 Structural Issues in Evergrande's Debt Crisis

Structural debt problems constitute one of the core aspects of Evergrande's financial crisis, primarily arising from the company's long-standing reliance on high leverage and an unstable funding structure, which collectively exposed its liabilities to substantial risks.

Evergrande's principal business lies in real estate development, with land acquisition serving as one of its major capital expenditures. As of December 31, 2022, the company held a land reserve of 210 million square meters. In addition, the group was involved in 79 urban renewal projects, including 55 in the Greater Bay Area (34 of which were in Shenzhen) and 24 in other cities. A significant share of Evergrande's liabilities was tied to land purchases. However, such acquisitions were financed largely through market-based land auctions and bank loans, rendering Evergrande's financing model highly sensitive to fluctuations in land prices and government policy shifts. When the land market experienced downturns, the company faced mounting financing difficulties, which in turn led to an even greater

accumulation of debt.

Evergrande's capital structure relied heavily on external borrowing, particularly short-term, high-interest debt and bank loans. In pursuit of rapid expansion, the company adopted an aggressive debt accumulation strategy, which resulted in excessively high financial leverage and steadily rising financing costs. With liquidity constraints intensifying, Evergrande's debt-servicing capacity deteriorated sharply, thereby amplifying the exposure of systemic risks.

2.2.2 Cash Flow Management Issues in the Evergrande Crisis

Cash flow management directly affects a firm's debt-servicing capacity and overall financial health. Evergrande's deficiencies in cash flow management were reflected across operating, investing, and financing activities. Between 2019 and 2022, the company consistently reported negative net operating cash flows of RMB -67.357 billion, -51.601 billion, and -12.217 billion, respectively. This indicates that its core business operations failed to generate sufficient cash inflows to cover operating expenditures, primarily due to sluggish market demand and prolonged sales collection cycles.

Similarly, Evergrande's investing activities produced continuous negative net cash flows, with RMB -55.308 billion in 2019, -24.128 billion in 2020, -14.407 billion in 2021, and -13.101 billion in 2022. This pattern demonstrates that the company's expansion strategy relied heavily on external financing to support asset acquisitions and construction projects, but these investments did not generate adequate cash returns in a timely manner.

Meanwhile, the firm's financing cash flows exhibited significant volatility. In 2019, net financing cash inflows reached RMB 143.163 billion. However, as financing conditions tightened and debt default risks escalated, figures dropped sharply to RMB -76.885 billion in 2020 and RMB -87.301 billion in 2021. Although net financing cash flow rebounded to a positive RMB 24.215 billion in 2022, this recovery proved insufficient to resolve Evergrande's liquidity shortage and alleviate its broader funding crisis.

2.2.3 Policy Tightening and Inadequate Risk Management

In 2018, when Vanke publicly emphasized the need to "survive" in response to tightening real estate policies and implemented strict cash management measures, Evergrande was still aggressively expanding its land reserves. In 2020, the People's Bank of China and the Ministry of Housing and Urban-Rural Development introduced the "Three Red Lines" policy, which required real estate developers to meet specific financial thresholds in order to access new borrowing. Due to its highly leveraged operations and excessive debt-to-asset ratio, Evergrande failed to satisfy these requirements, resulting in an immediate contraction of its financing channels.

The policy directly restricted Evergrande's capacity to refinance maturing obligations, thereby preventing it from sustaining liquidity through debt rollover strategies. The company also failed to adjust promptly to the shifting policy environment, particularly during a period of intensifying real estate market bubbles, and did not adopt effective risk management measures to restructure its operations. While government regulatory measures contributed to stabilizing the broader property market, the tightening of credit policies significantly heightened Evergrande's refinancing difficulties, ultimately triggering the breakdown of its funding chain.

2.3 Measures for Resolving Evergrande's Debt Crisis

2.3.1 Government Support Combined with Market Mechanisms

The government plays a pivotal yet cautious role in mitigating Evergrande's crisis. Limited fiscal support or policy measures may ease liquidity pressures, while direct monetary expansion should be avoided to prevent inflationary risks. Local governments can establish special funds or partner with real estate firms to revive stalled projects, thereby restoring cash flow, ensuring housing delivery, and stabilizing consumer confidence. Partial state guarantees on Evergrande's unrepaid debts could also reduce financial institutions' risk exposure, though guarantees should be strictly capped.

2.3.2 Land Auctions and Asset Disposal

As of December 31, 2022, Evergrande held 210 million square meters of land reserves, much of it in less attractive suburban or rural areas. To accelerate asset monetization, local governments may adjust auction strategies—such as phased sales and flexible pricing—to enhance marketability and attract developers.

2.3.3 Debt Restructuring and Strategic Investor Introduction

Debt restructuring remains central to resolving the crisis. Introducing strategic investors, particularly state-owned enterprises, through mergers or acquisitions could reduce debt pressure. State-owned firms, leveraging policy advantages and resources, may stabilize projects, integrate assets, and mitigate default risks.

3. Analysis of PwC's Audit Failures and the Resulting Penalties

3.1 Internal Causes of PwC's Audit Failure

3.1.1 Accountability in Audit Oversight

Raymund Chao, as Chairman, Senior Partner, and CEO of PwC Asia-Pacific and China, bore ultimate responsibility for audit failures. He failed to ensure audit quality and independence, prioritizing personal interests over effective supervision^[5].

3.1.2 Managerial Incentives and High Compensation

Chao regarded Evergrande as a key client while pursuing high personal income—reportedly HKD 50 million with a tax rate as low as 7.5%. Such financial incentives created a conflict of interest that undermined independence and contributed to audit deficiencies^[6].

3.1.3 Audit Quality Management as a Political Tool

Chao allegedly used audit quality management positions as instruments of internal political struggle, consolidating power through loyalists and marginalizing dissenters. This practice compromised professionalism and weakened audit quality.

3.1.4 Independence and Ancillary Services

PwC provided Evergrande and Hui Ka Yan's family office with tax advisory and cross-border transaction services. These additional engagements blurred professional boundaries, increased risk of conflicts of interest and eroded audit independence when assessing Evergrande's financial health.

3.2 Comparison of Domestic and International Penalties for Audit Misconduct

3.2.1 PwC's Joint Sanctions in China

For violations in Evergrande's 2018 audit, China's Ministry of Finance confiscated illicit gains, imposed a RMB 116 million fine, suspended operations for six months, and revoked PwC Guangzhou's license. Four signing auditors had their licenses revoked, while seven others received warnings or fines.

The China Securities Regulatory Commission (CSRC) further imposed confiscation of RMB 27.74 million and an additional fine of RMB 297 million, totaling RMB 441 million in joint penalties. Although CSRC did not suspend PwC's securities services, the coordinated measures signaled regulatory zero tolerance toward financial fraud. Cross-border investigations into PwC Hong Kong also underscored strengthened international audit oversight^[7].

3.2.2 Arthur Andersen's Sanctions in the U.S

A U.S. federal court convicted Arthur Andersen of obstruction of justice in relation to the Enron case, imposing a fine of USD 500,000 (some reports cite USD 7 million) and barring it from practicing accounting for five years. Though the Supreme Court later overturned the conviction, Andersen's reputation had already collapsed, triggering massive client loss and eventual bankruptcy^[8].

The case marked the dissolution of one of the "Big Five," reducing the global market to the "Big Four." It remains a landmark warning on the critical importance of auditor independence and integrity.

3.3 Relative Limitations of China's Sanctions

Although the fines imposed on PwC in China were substantial, their overall impact on the firm's operations was limited. Accountability for individual auditors remained relatively light, with no criminal liabilities imposed. Furthermore, no mandatory internal reforms or governance improvements were required, raising concerns about preventing future recurrence.

Recommendations and Implications: To strengthen audit oversight and accountability, China should

enhance the deterrent effect of sanctions. Key measures include: Stricter individual accountability: Introduce criminal liability for serious negligence to reinforce responsibility. Broader business restrictions: Consider wider suspensions or phased exit measures for firms with severe violations. Enhanced regulatory framework: Strengthen requirements for audit quality control and governance structures to ensure systemic improvements. Cross-agency coordination: Foster joint supervision among financial regulators, judicial bodies, and professional associations to achieve comprehensive and lasting oversight^[1].

Compared with mature Western markets, China's audit regulatory system still has room for improvement. By implementing more rigorous sanctions and institutional reforms, the integrity and independence of the auditing profession can be significantly enhanced.

4. Risk Management Strategies: A Dual Perspective of Real Estate Enterprises and Accounting Firms

4.1 Risk Management Strategies for the Real Estate Sector

4.1.1 Diversified Financing and Capital Structure Optimization

The Evergrande crisis underscored the risks of excessive leverage and overreliance on external debt. Real estate firms should adopt more prudent financing strategies, strictly controlling debt levels and costs while avoiding mismatches between short-term high leverage and long-term low returns. Optimizing debt structures, reducing dependence on short-term loans, and setting prudent leverage limits with regular debt reviews can help identify risks early and prevent crises driven by overexpansion.

Evergrande's downfall was rooted in an imbalanced capital structure with concentrated risk due to excessive debt financing. To mitigate this, firms should diversify funding sources by incorporating equity financing, asset securitization (ABS), and other innovative instruments, thereby reducing dependence on traditional bank loans. Introducing strategic investors, pursuing listings, or refinancing through capital markets can strengthen capital structures and distribute risks more effectively. Ensuring a balanced mix of equity and debt will enhance resilience to market fluctuations, reducing vulnerability to liquidity shocks and financial distress.

4.1.2 Economic Forecasting and Policy Compliance

Since the commercialization of housing in 1998, China's real estate policies have evolved with economic cycles. By 2003, the sector had become a pillar of the national economy, entering a "golden era." From 2014 to 2016, strong stimulus measures—including tax cuts, interest rate reductions, destocking, and urban renewal—were introduced. Although the "housing is for living, not for speculation" principle was established in late 2016, housing prices across cities at all tiers continued to surge. In August 2020, the "three red lines" policy and, later that year, real estate loan concentration rules tightened credit, triggering a nationwide downturn^[1].

Faced with shifting policies and external shocks, real estate firms must strengthen adaptability. Under stricter regulation, firms should adjust project strategies in a timely manner to avoid policy-induced financial burdens. As financing is often restricted by such measures, companies need contingency plans to preserve financial stability under policy pressure.

Accordingly, firms should closely monitor macroeconomic trends and policy directions, adopt flexible operational and investment strategies, and anticipate cyclical shifts. Adjusting land reserves, sales schedules, and investment plans can mitigate risks, while compliance with regulatory requirements and avoiding excessive land expansion are critical to ensuring sustainable and resilient development.

4.1.3 Strengthening Corporate Governance and Transparency

The Evergrande crisis exposed deep-rooted weaknesses in corporate governance and financial transparency. Nearly 65% of the company's shares were controlled by the Xu Jiayin family, leaving minority and public shareholders unable to provide effective checks and balances. As a result, the board of directors and supervisory bodies were largely symbolic, failing to independently oversee management. Such concentration of ownership fostered "one-man rule," heightened governance risks, and encouraged decisions prioritizing personal interests over corporate sustainability. For example, Xu repeatedly arranged excessive dividends that strained liquidity, while management manipulated financial reports to conceal true conditions and attract financing, further eroding investor confidence and aggravating liquidity pressures^[8].

To mitigate such risks, real estate firms should strengthen governance structures and enhance financial transparency. Equity concentration should be reduced to ensure minority shareholder participation, while independent and accountable boards and supervisory bodies should be established to prevent insider control. Firms must also ensure timely and accurate disclosure of decisions and financial information to protect investor rights and market trust^[11].

In practice, companies should conduct regular independent audits of key financial data and major projects to verify management decisions. Moreover, fostering an open, transparent, and accountable corporate culture can strengthen trust among employees, customers, and investors. Encouraging diverse decision-making and reducing overreliance on individual leaders will further improve governance capacity and enhance long-term competitiveness.

4.2 Risk Management Strategies for Accounting Firms

4.2.1 Strengthening Risk Isolation and Safeguarding Audit Independence

In China, audit firms are engaged and remunerated by enterprises, and their reports influence both investors' decisions and government tax administration. However, reliance on client-paid fees may compromise auditor independence, leading to misstatements or fraudulent reporting. This not only undermines investor protection but also weakens regulatory oversight and fiscal governance. Strengthening risk-isolation mechanisms is therefore essential to ensure independence and impartiality.

To mitigate conflicts of interest, audit firms should: first, prohibit economic ties with clients beyond professional services; second impose time limits on continuous engagements to avoid over-familiarity; and third establish independent supervisory committees to review audit procedures and quality.

Moreover, legal frameworks should clarify auditors' liabilities and reinforce professional ethics. Severe sanctions should be applied to major failures or fraud, while continuous training and updated professional guidelines should enhance auditors' capacity to address complex financial issues. Only through layered institutional safeguards and effective oversight can genuine audit independence be achieved, thereby protecting market fairness and stakeholder interests.

4.2.2 Specialized Audit Teams and Standardization of Practice

The audit failure of PwC in the Evergrande case revealed multiple issues, particularly the suspected overstatement of revenue in the 2019 and 2020 financial statements. As disclosed in Note 2 of Evergrande's reports, the company significantly changed its revenue recognition policy. Previously, revenue was recognized once a buyer accepted the property or signed a contract. Since 2021, however, under the new accounting standard, revenue could only be recognized upon project completion or property delivery. This adjustment illustrates the substantial impact of accounting standards and revenue recognition rules on financial disclosure.

Given the growing complexity of business models, audit firms should establish industry-specialized teams to strengthen expertise. In the real estate sector, this entails consistent application of standards for revenue recognition, asset valuation, and presale fund management. Specialized teams familiar with project development, land reserves, and presale practices can better identify sector-specific risks. Moreover, firms should standardize audit processes, adopt unified methodologies, implement strict quality reviews, and ensure consistency across teams. For complex cases, interdisciplinary collaboration with legal, tax, and industry experts can enhance audit depth and reliability^[9].

Continuous training on updated accounting standards is also essential to ensure accurate application in practice. Only through the dual reinforcement of specialization and standardization can audit firms effectively manage complex engagements, safeguard transparency and reliability of financial reporting, and maintain investor and market confidence.

4.2.3 Internal Risk Control and Governance Optimization

In the Evergrande audit, excessive concentration of power by PwC Asia-Pacific Chairman Raymond Chao undermined internal governance and contributed to audit failure. According to public reports, he monopolized the engagement and suppressed partners who questioned audit quality, thereby weakening internal oversight and risk controls.

To prevent similar issues, audit firms should strengthen governance and client risk management. Measures include: conducting thorough due diligence on prospective clients to identify high-risk entities; allocating senior teams and additional resources to major or high-risk engagements; implementing

dynamic risk assessments and independent multi-level reviews to avoid power concentration; and clearly separating audit, tax, and advisory functions to prevent conflicts of interest. Establishing independent quality-control units, enhancing professional ethics, and enforcing whistleblowing and accountability mechanisms are also essential.

Clarifying departmental responsibilities and reinforcing internal reporting channels can further ensure audit independence and quality, thereby improving governance and maintaining market confidence.

5. Conclusion

5.1 Research Contributions and Significance

This paper takes the Evergrande debt crisis and PwC's audit failure as a representative case to examine the interaction between high leverage, policy tightening, cash flow deficiencies, corporate governance weaknesses, and insufficient audit independence. The comparative analysis with Vanke and Country Garden reveals Evergrande's severe deterioration in profitability and solvency, while the investigation of PwC demonstrates how internal governance imbalances and the erosion of independence damaged market credibility. Reference to the Arthur Andersen case further highlights differences between domestic and international sanctions, offering lessons for regulatory improvement in China^[10].

The study makes four main contributions. First, from the enterprise perspective, it identifies the systemic risks inherent in highly leveraged financing models and poor cash flow management. Second, from the corporate governance perspective, it illustrates how ownership concentration and ineffective internal supervision exacerbate financial vulnerability. Third, from the auditing perspective, it underscores the critical role of audit independence and sound internal governance for maintaining capital market trust. Fourth, through international comparison, it provides practical insights for strengthening China's audit regulatory framework. Collectively, these findings help prevent risks in the real estate sector, promote standardization in the auditing profession, and enhance capital market transparency.

5.2 Limitations and Future Directions

Despite its contributions, this study has several limitations. It relies mainly on public financial data and case reports, lacking access to internal operational and audit details, which may limit the depth of analysis. Methodologically, it is grounded in case and comparative analysis, without empirical testing on large samples, which restricts the robustness of the conclusions^[12]. Furthermore, the focus on Evergrande and PwC, while highly illustrative, raises concerns about external generalizability.

Future research can be advanced in three directions. First, by employing large-sample firm-level data and econometric methods, future studies can empirically validate the links between capital structure, governance quality, and risk exposure in real estate enterprises. Second, comparative research across different accounting firms and regulatory environments can improve the universality of conclusions on governance and audit independence. Third, future work should explore the dynamic interaction between regulatory evolution, enterprise risk management, and capital market stability, thereby offering evidence-based support for policymaking and industry reform^[13].

In summary, this study not only deepens understanding of the Evergrande crisis and PwC's audit failure but also provides broader implications for enterprise risk control, the development of auditing standards, and the long-term stability of China's financial system.

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