

Analysis of IPO Audit Risks and Countermeasures under the Registration System

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Abstract: The reform of the registration system is a major fundamental institutional reform in the capital market, which has had a profound impact on intermediary institutions such as listed companies and accounting firms since its pilot period. The registration system has strengthened the responsibility of the "gatekeeper" in the accounting firm market, placing higher demands on accounting firms and auditors to improve the quality of IPO audits and reduce IPO audit risks. The article explores the impact of registration system on IPO audit, analyzes the risks of IPO audit under the influence of registration system, and provides countermeasures and suggestions for preventing IPO audit risks.

1. Introduction

After the implementation of the registration system, the number of IPOs and total fundraising of enterprises have repeatedly reached new highs. Affected by the downward pressure of the economy, many enterprises choose to falsely disclose their financial information in order to achieve the purpose of listing, and the phenomenon of "breaking through barriers with illness" frequently occurs. According to the disclosure announcement of the China Securities Regulatory Commission, in recent years, the regulatory requirements for IPOs have become increasingly strict. In 2022, there were a total of 293 companies that had their IPOs terminated, of which 270 voluntarily withdrew their applications during the review and inquiry stage, accounting for a high proportion of 92%. The fact that so many companies' IPOs are withdrawn upon investigation indicates that the proposed listed companies themselves have flaws, and also reflects the problems of some accounting firms' lax control and high IPO audit risks. The article first reveals the impact of registration system on IPO audit from three perspectives; Secondly, conduct in-depth analysis of IPO audit risks such as revenue determination risks under the influence of the registration system; Finally, provide some countermeasures and suggestions to prevent IPO audit risks.

2. The Impact of Registration System on IPO Audit

2.1. Changes in IPO issuance conditions

Compared to the approval system, the registration system for changes in issuance conditions has lowered the threshold for enterprises to go public and established multiple sets of financial standards. The positioning of the Science and Technology Innovation Board, ChiNext Board, and Beijing Stock Exchange focuses on technology innovation and growth oriented enterprises. Part of the mandatory indicators in the IPO issuance conditions of enterprises under the approval system are converted into the requirements for the growth and sustainable operation ability of enterprises under the registration system, allowing unprofitable enterprises to go public.^[1] The relaxation of the issuance conditions for this series of IPOs aims to enhance market inclusivity and encourage more high-quality and promising companies to go public. However, compared to mature enterprises, innovative enterprises have higher operational risks, especially technology innovation enterprises. Due to their short establishment time and large R&D investment scale, it is difficult to achieve profitability in the short term. If auditors lose their professional skepticism due to relaxed issuance conditions, they may not

be able to obtain sufficient and appropriate audit evidence due to a lack of comprehensive understanding of the proposed listed enterprise and the industry, thereby increasing audit risks. In this regard, auditors should have more diversified professional knowledge and abilities, and be able to apply more accurate risk identification and response measures to enterprises in different industries and development stages.

2.2. Information disclosure requirements

The registration system for information disclosure requires information disclosure as the core, and regulatory authorities no longer conduct substantive audits of proposed listed companies. Instead, they supervise the comprehensiveness, accuracy, authenticity, and timeliness of their disclosed information through audit inquiries, on-site inspections, and other means. Under the influence of the registration system, the quality of information disclosure has become the key to the success of corporate IPOs, while also increasing the professional risks of accounting firms. Specifically, in the context of the registration system, accounting firms not only need to issue audit reports on the financial statements of the proposed listed company for the past three years and one period, but also need to respond to relevant questions in the regulatory inquiry letter. The difficulty of IPO audit work and regulatory pressure have increased the risk of IPO audit. Secondly, there are many problems with the IPO application companies themselves, with inherent risks such as internal control deficiencies and incomplete financial systems much higher than those of listed companies. However, in order to achieve the purpose of raising funds, companies planning to be listed have numerous financial fraud and fraudulent means. After the revision and implementation of the new Securities Law, accounting firms have been included in the scope of civil liability for false statements, increasing the upper limit of their administrative penalty liability. Accounting firms will bear joint and several liability for failure to diligently fulfill their responsibilities, or direct responsibility for false statements, which undoubtedly increases the legal risk of accounting firms in ensuring the authenticity and legality of enterprise information in IPO audits.

2.3. Strengthening the Responsibility of Intermediaries

The reform of the registration system has strengthened the responsibility of intermediary institutions as gatekeepers of the capital market, requiring enterprises and intermediary institutions to "declare and take responsibility", further consolidating the responsibility of accounting firms to control the quality of listed companies. If accounting firms and auditors fail to fulfill their due responsibilities or even violate laws and regulations, they will be severely held accountable. According to statistics, from January 1, 2022 to December 31, 2022, various financial departments (bureaus) have imposed administrative penalties on 174 accounting firms and 418 registered accountants, with a year-on-year increase of 104.71% and 294.34%, exceeding the total amount of administrative penalties in the previous three years. The registration system strengthens the responsibilities of accounting firms and will face greater regulatory pressure in the future.

3. IPO audit risks under the influence of registration system

3.1. Revenue recognition risk

Revenue is an important indicator to measure a company's profitability, and only when there is revenue can there be profit. The net profit indicator is also one of the conditions for IPO listing, and revenue is also a key reporting item that investors pay attention to. Therefore, income fraud has also become a "disaster zone" for financial fraud in IPO application companies. In this regard, when auditing revenue, the following points should be emphasized: ① Accounting policies for revenue recognition. According to the new income standards, the recognition method for corporate income can be divided into time point method or time period method. In practice, it is also necessary to determine whether the transfer of substantive control is marked by acceptance or physical transfer according to contract provisions. Revenue is recognized using the total amount method and net amount method respectively based on whether the enterprise is the main responsible person or agent.

- ② Original documents related to revenue recognition. Carefully inspect accounting documents, contracts, correspondence, etc. as evidence to determine the true occurrence of income. ③ Gross profit margin and income fluctuations. The level of gross profit margin and income are influenced by many factors, and once there are abnormal fluctuations, it is necessary to carefully analyze the reasons. ④ The proportion and fairness of related party transaction income. Abnormal related party transactions are the main reason for the rejection of IPOs due to income issues. When the proportion of related party transactions is too high and there is no reasonable commercial reason, the authenticity of the transaction should be carefully verified and the risk of income fraud should be considered.^[2]

3.2. R&D investment risk

The requirements for IPO application on the Science and Technology Innovation Board and the Growth Enterprise Board both include provisions on research and development investment. Among them, the listing conditions of the Science and Technology Innovation Board include a financial indicator of "the proportion of accumulated research and development investment in the past three years to the accumulated operating revenue in the past three years shall not be less than 15%". In recent years, companies that falsely declare high-tech enterprises, forge R&D projects, and falsely increase R&D investment have been subjected to high-pressure scrutiny. When reviewing whether the proposed IPO company is positioned in the "three innovations and four innovations" section of the Science and Technology Innovation Board, research and development investment has also become the focus of IPO review. In this regard, when auditing research and development investment, attention should be paid to the following points: ① The authenticity of research and development projects. Auditors should understand the company's R&D strategy, judge the authenticity of R&D projects based on the company's research objectives and industry positioning, analyze whether there are intentional delays in capitalization timing, and whether there is a risk of inflated R&D expenses and intangible assets. ② Research and development expense accounting system. Auditors should analyze how R&D expenses are collected, whether there are situations where cost expenses are not separated from R&D expenses, salary accounting for personnel in various departments is mixed, and R&D material requisition is not standardized.

3.3. Going concern risk

One noteworthy point in the registration system issuance conditions is to change the requirement of "continuous profitability" to "continuous operating ability". This change seems to have relaxed the listing conditions, but in reality, it focuses on verifying whether a company can achieve high-quality and sustainable development. Even if the profit level of the proposed listed company is high, it will still fail due to significant risks in its ability to continue as a going concern. When auditing a company's ability to continue as a going concern, attention should be paid to the following points: ① Matters or situations that have significant doubts about its ability to continue as a going concern. When performing audit procedures, auditors should pay attention to the industry environment in which the enterprise is located, and based on financial statements and other data, determine whether there is a significant risk of breach of contract, a large number of litigation and arbitration, and other abnormal situations, which can have an adverse impact on the company's ability to continue as a going concern.^[3] ② Management's assessment of sustainable business capabilities. Auditors should carefully consider whether the management's evaluation of the company's ability to continue as a going concern is true and in line with the true state of the company. ③ Significant uncertainty in matters or situations that raise significant doubts about the ability to continue as a going concern. Accounting firms should consider the future response plans made by management regarding their ability to continue operations and determine the feasibility of their response plans.

4. Countermeasures for IPO Audit Risks under the Registration System

4.1. Enhancing the professional competence of auditors

In the context of the registration system, auditors will be involved in an increasing number of emerging industries when conducting IPO audits, facing the complex and diverse internal environment and business of enterprises. If they still follow the old auditing methods, they will be unable to accurately identify and respond to major misstatement risks in the current market environment. Firstly, it is necessary for auditors to consciously enhance their professional competence, keep up with the times, expand their knowledge reserves, and improve their professional competence level. ^[4] The IPO audit work itself has the characteristics of complex work procedures and long audit cycles, coupled with fierce competition in the audit market of accounting firms. If auditors do not attach importance to cultivating their own qualities, they may face being eliminated by the market. Secondly, accounting firms should establish effective internal systems and continuously enhance the risk awareness of auditors. In addition, accounting firms can also introduce versatile talents.

4.2. Enhance awareness of information disclosure responsibility

Under the influence of the registration system, regulatory agencies have gradually transitioned from pre supervision to in process and post supervision in the audit of proposed listed companies, while accounting firms' regulatory responsibility for the quality of IPO information disclosure of enterprises continues to strengthen. ^[5] Auditors should enhance their awareness of the responsibility for information disclosure by issuers of planned listed companies, and focus audit resources on areas with high difficulty and risk. Not only that, auditors should also pay attention to the recording and preservation of audit work papers, and disclose in detail the significant misstatement risks of enterprise financial reports and the audit procedures implemented in the audit work papers. Auditors should adhere to the principle of independence, maintain a professional skepticism attitude, spare no effort in verifying uncertain projects, collect sufficient audit evidence that can be mutually corroborated through various channels, and follow audit standards to be diligent and responsible.

4.3. Establish a sound quality management system

Accounting firms should establish a quality management system that is suitable for their own business needs based on their specific circumstances, relevant laws and regulations, and industry practice standards. For IPO audit business, establishing a complete, institutionalized, and operable work procedure can effectively reduce IPO audit risks and enable it to better play the role of audit. Firstly, when undertaking IPO audit services, accounting firms should conduct risk assessments, adhere to a quality oriented approach, do not undertake IPO audit services for enterprises with abnormally high risks. Secondly, it is necessary to achieve the integration of the quality management system within all accounting firms, strictly requiring all relevant personnel to follow the provisions of the quality management system, and regularly checking the operation of the quality management system.

5. Conclusion

The gradual implementation of the registration system has had a series of impacts on the IPO audit business. Due to the change in IPO issuance conditions under the registration system and the strengthening of the responsibility of accounting firms with information disclosure as the core concept, higher requirements have been put forward for accounting firms and auditors to carry out IPO audit services. In the face of new challenges in the new situation, auditors should enhance their own abilities and enhance their awareness of information disclosure responsibility. Accounting firms should also establish a sound quality management system and strictly adhere to the audit philosophy of quality first in order to better improve the quality of IPO audits and reduce IPO audit risks to a reasonable level.

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