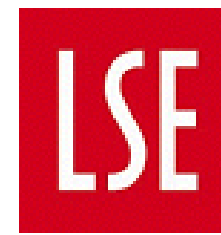




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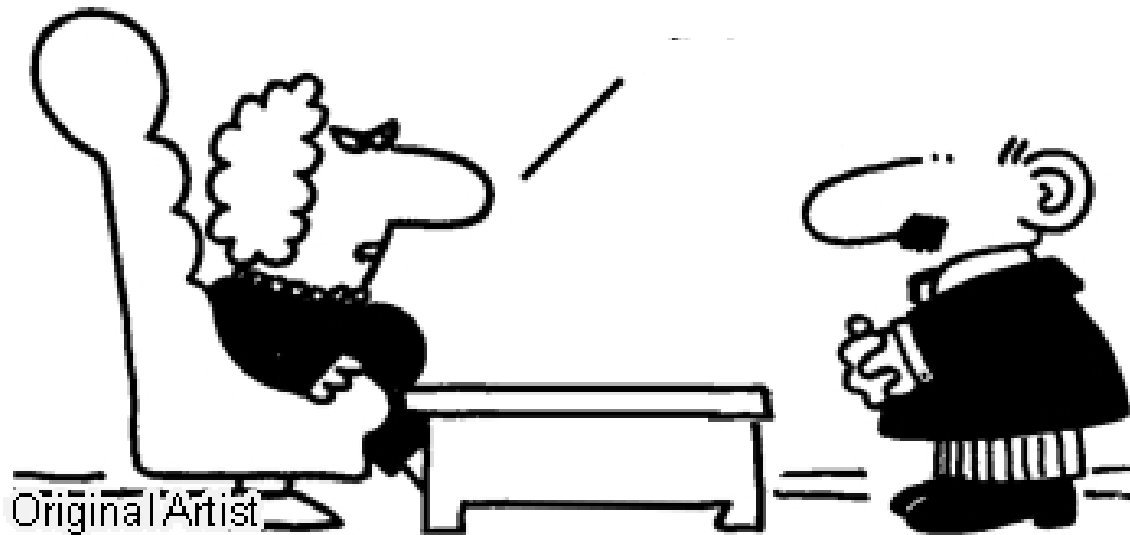
The origination and development of China's audit firms

Shuwen Deng (SUFE) and Richard Macve (LSE)

AAA Annual Meeting August 4-8

Washington DC

Every time I want to get a
client, you tell me I own it
already!



**Will the next 'Big N' international
firm be a Chinese CPA firm?**

Will the next 'Big N' international firm be a **Chinese** CPA firm?

- The history of the origination and development of China's **audit firms**
- The evolution of China's **audit industry structure**
- China's **ongoing attempts** to develop its indigenous firms
- The **opportunities and challenges** now faced by China's audit firms.

The origination and development of China's audit firms

State audit

- Western Zhōu dynasty (1100-771BC)

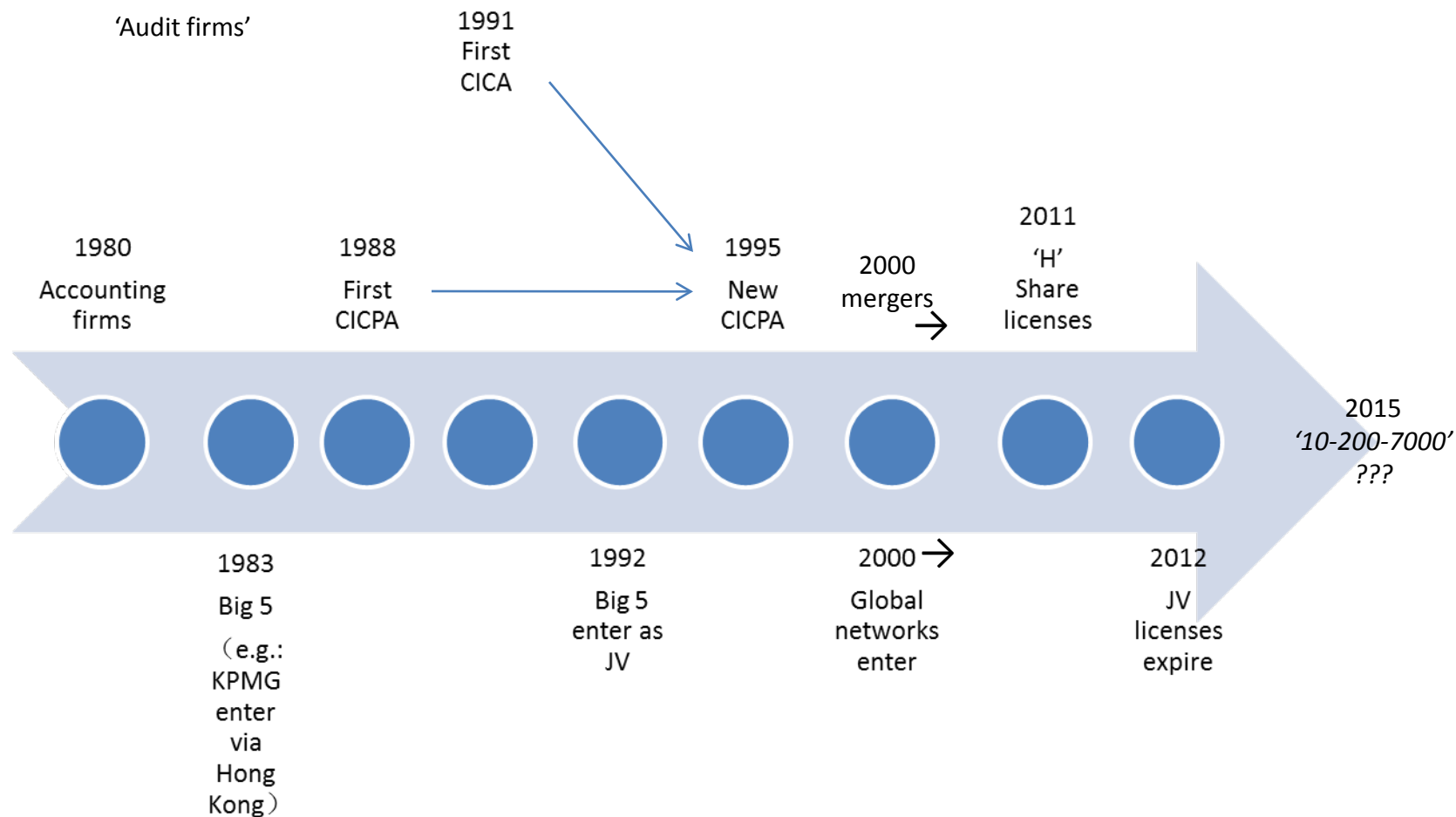
Private audit industry

- Originated in 1920s
- Stagnated in 1956
- Reconstructed in the 1980s

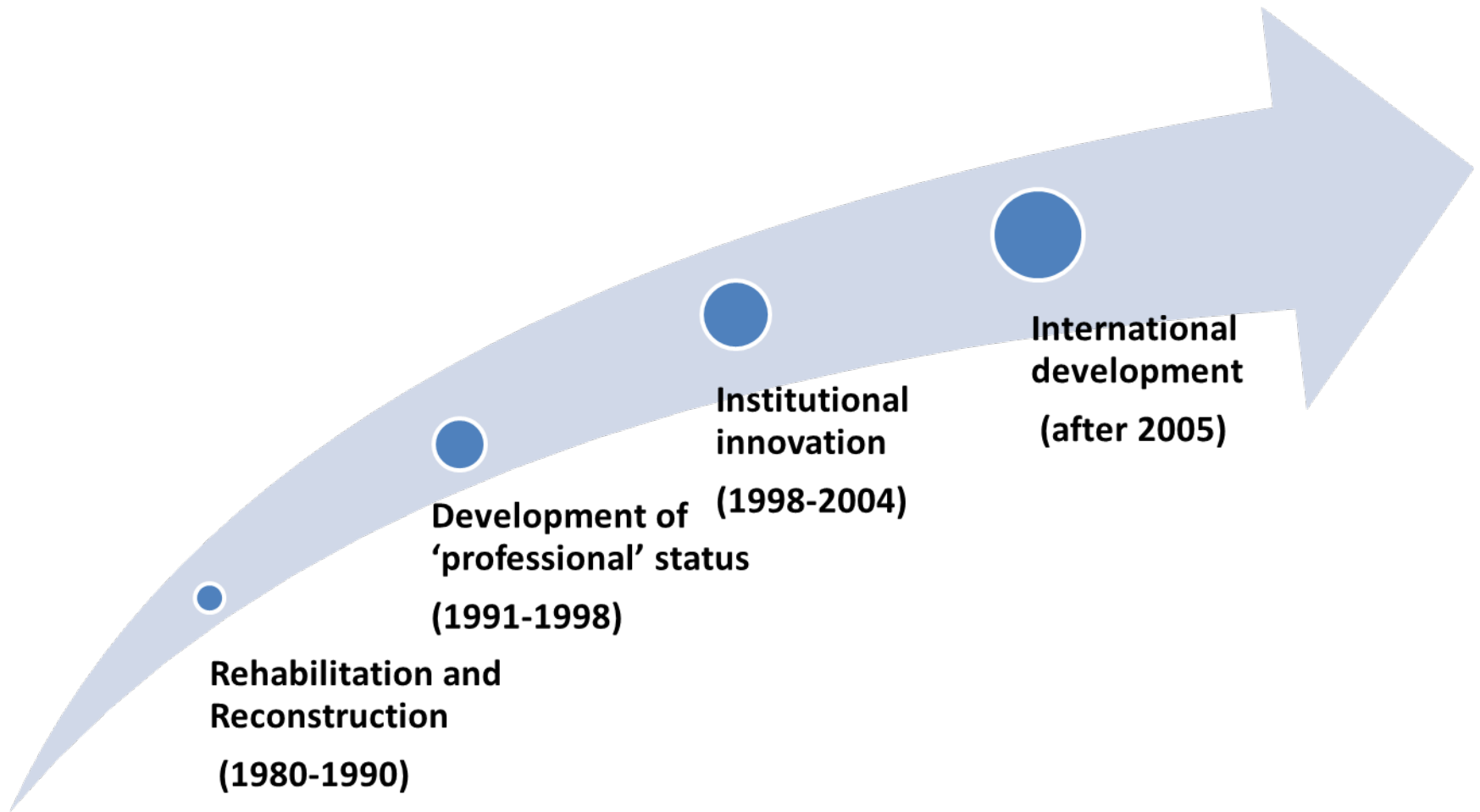
SAA
(CNAO)

MoF

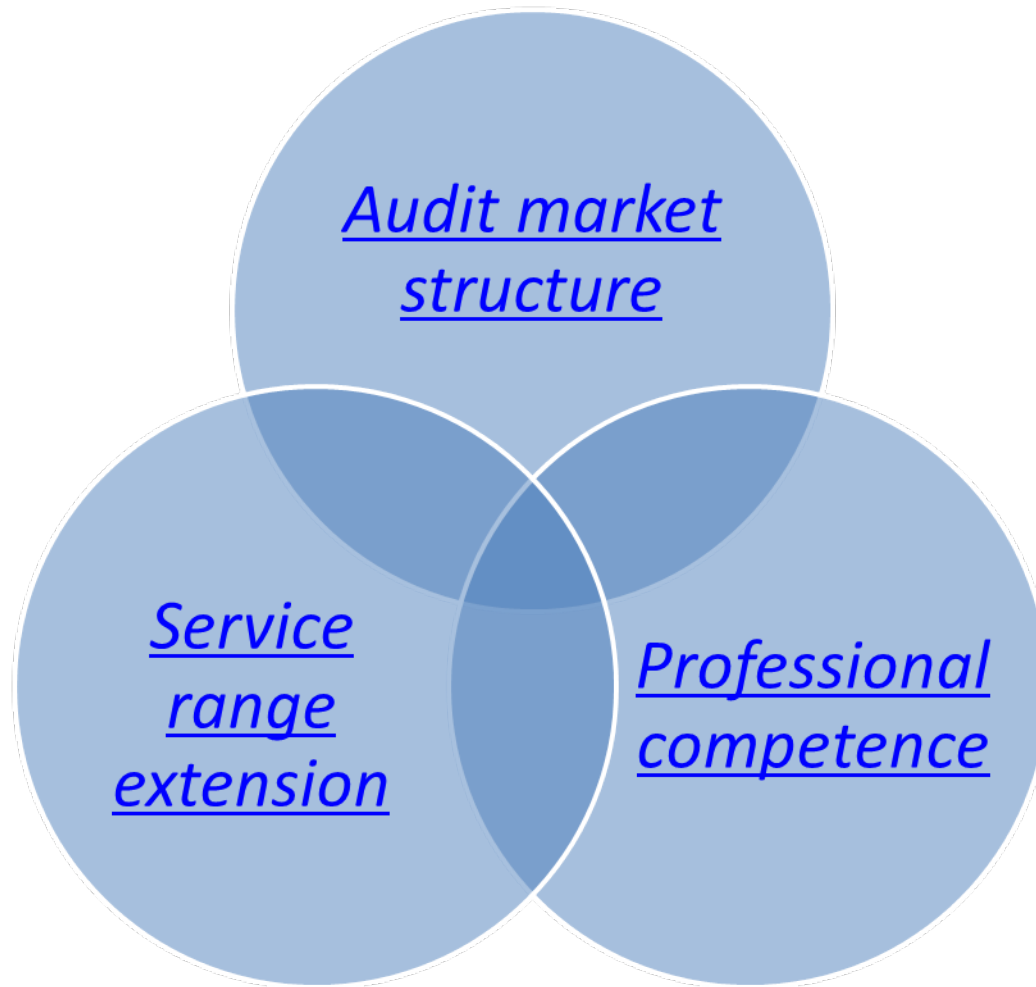
Foreign
audit
firms



4 stages of the evolution of China's audit industry

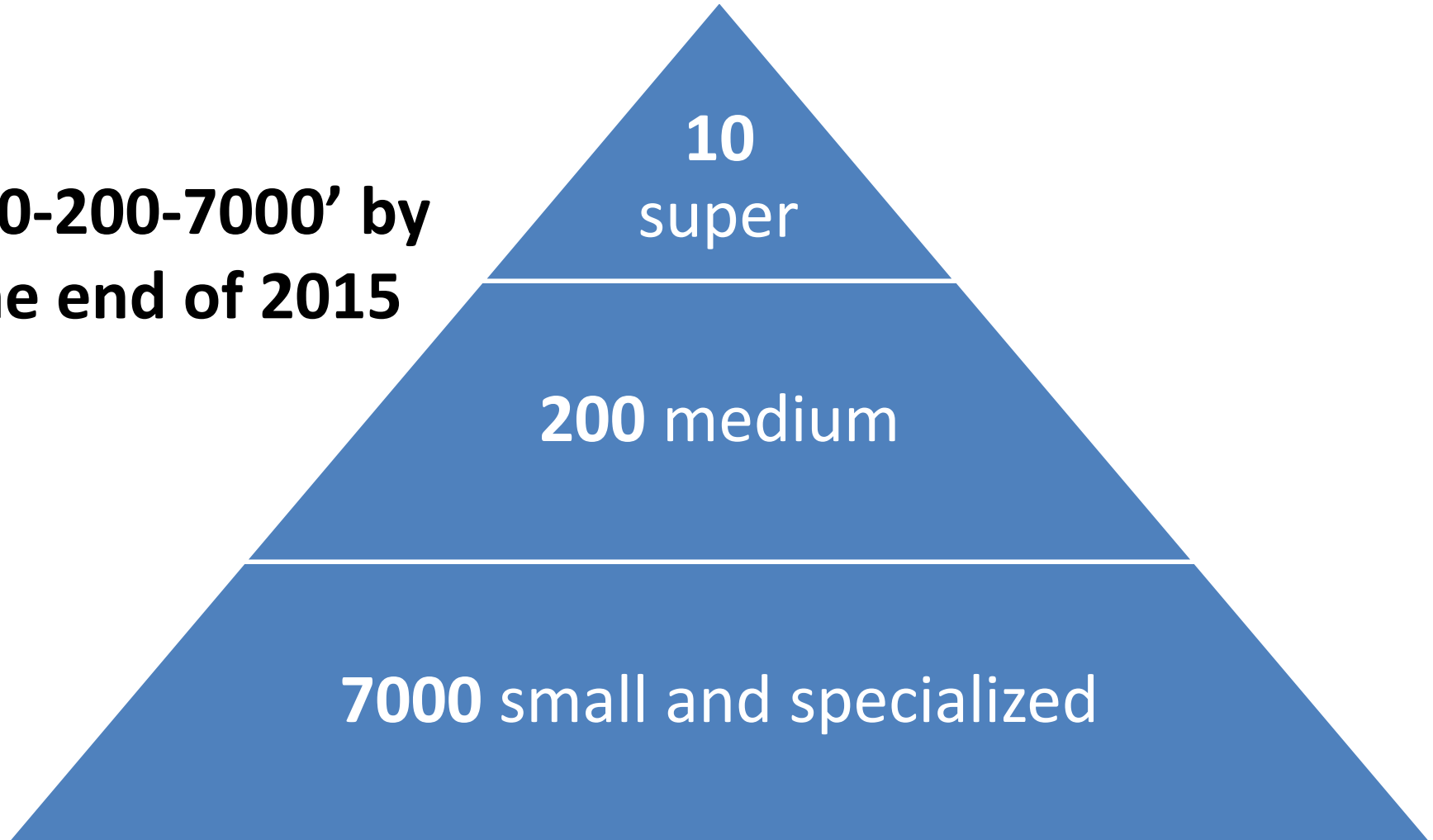


Context



Context (1): *Audit market structure*

**'10-200-7000' by
the end of 2015**



Home and overseas audit markets

Domestic firms and domestic IPOs

Produce the next 'Big 5 firm' just by size.

Chinese companies investing overseas

Worldwide coverage

Overseas listing

**H-share
UK/US Listing?**

Automobile JVs and brands?

Watch these names...the Chinese CPA firms that now have 'H-share' licenses

- 立信会计师事务所 *lìxìn kuàijìshī shìwùsuǒ*
BDO CHINA SHU LUN PAN Certified Public Accountants LLP
- 天健会计师事务所 *tiānjiàn kuàijìshī shìwùsuǒ*
Pan-China Certified Public Accountants
- 大华会计师事务所 *dàhuá kuàijìshī shìwùsuǒ*
Da Hua Certified Public Accountants
[Member of BDO international network]
- 京都天华会计师事务所 *jīngdūtiānhuá kuàijìshī shìwùsuǒ*
Grant Thornton China

The Chinese CPA firms that now have H-share licenses (cont)

- 信永中和会计师事务所 *xìnyǒngzhōnghé kuàijìshī shìwùsuǒ*

ShineWing Certified Public Accountants

[participates in Praxity international network]

- 国富浩华会计师事务所 *guófùhàohuá kuàijìshī shìwùsuǒ*

Crowe Horwath China CPAs

- 中瑞岳华会计师事务所 *zhōngruìyuèhuá kuàijìshī shìwùsuǒ*

RSM China Certified Public Accountants Co. Ltd

- 大信会计师事务所 *dàxìn kuàijìshī shìwùsuǒ*

Daxin Certified Public Accountants

[Member of PKF international network]

PLUS the Big 4 JVs: now under threat

Context (2): *Service range extension*

- **Non Audit Service**

- Management consultancy
- Internal control strategies
- Mergers and acquisitions (M&A)
- Credit investigation
- Performance evaluation
- Investment strategies

.....

- **Accelerate transformation and upgrading**
- **Concern about ‘independence’**

Context (3): *Professional competence*

- Learn from the foreign partners
- Achieved ISA convergence and (nearly) IAS/IFRS
- Encourages increasingly mature firms to take on work on their own
- Reciprocal relationships with international professional qualifications

Evaluation of the current situation

- 3 of the Big 4 JV licenses will expire in 2012. But there are still not enough **competent** indigenous audit firms that could provide auditing services for China's biggest listed companies.
- Chinese indigenous audit firms still cannot compete with the Big 4 in terms of **reputation** or **perceived independence from Government influence**.
- Our interviews
 - the extent of Chinese Government influence over firms and CICPA remains hard to estimate.

Evaluation of the current situation (cont..)

- The **risk control** procedures
 - Not yet mature
 - New clients and new audit risks
 - legal liability risk
 - Deng (2011): merged firms select clients to reduce more visible client risks but not those they think are less well understood by investors.
- Insurance or Assurance
- Re-focus on **quality signalling** after mergers
- The role of IAS/IFRS and ISA in enabling local firms to say they operate the same standards.

The ambiguous role of IAS/IFRS and ISA?

- **Indigenous standards**

- Qín Shǐhuáng (3rd century BC).

- **Current standards**

- Just ‘from Heaven’

- **Mennicken (2008)**

- Compare the experience of ‘translation’ of ISA into Russian audit practice

2 May 2012 Guidelines

on the shape of the restructuring of the Big 4

- **Partners**

- can continue to have up to 40% ‘foreign partners’ without the CICPA qualification from 2012
- drops to 20% by 2017

- **Management committee**

- must not have more than 40% ‘foreigners’ without the CICPA qualification from 2012
- also reducing to 20% by 2017

- **Chairman/managing partner**

- must be a Chinese national and a Chinese CPA
- 3-year transitional relief

Some conclusions

- **Both opportunities and challenges.**
- **The Government vision** is to create sufficient numbers of large indigenous audit firms to provide audit and consultancy services to large SOEs and rival the Big 4 and other international networks.
- **UK interviewees** support Deng(2012)'s China analysis that the merger process should bring incentives to improve risk control - but only in the longer-run?
- **The 'practical' solution** is tendency to join the '2nd-tier' international networks.

Some conclusions (cont...)

- **Networks** allow 'independence' of Chinese CPA firm with easier access to international recourses.
- Big 4 argue that '**localisation**' from JV to local CPA dominated partnerships will evolve naturally but partner promotions should not be rushed: ***but Government want to accelerate this process...***
- **Hong Kong partners** still dominate: face difficulties in taking CPA exams in Mandarin.
- **Government influence** also acts through SOE appointments and IPO authorisations (but major central state-owned financial institutions still want Big 4).

Some conclusions (cont...)

- MOF / CICPA using 2012 JV license expiry to put pressure on Big 4 whose market share is now declining. But US making difficulties over inspection of audit working papers for US listed firms..... **‘stand-off’**
- Indigenous firms increasingly represented in CICPA hierarchy (e.g. Zhang Ke, Chairman of ShineWing is now CICPA Vice-President)
http://www.cicpa.org.cn/association_intro/council/201201/t20120120_32243.htm
- China's sheer size can change the world ranking of audit-consulting firms, only **the speed** of change is hard to predict.
- **Rapidly changing situation: see ‘China Accounting Blog’**
<http://www.chinaaccountingblog.com/weblog/>



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Watch this space....!!

For more...

carol119@126.com

R.Macve@lse.ac.uk