

The Future Structure of the Global Accounting and Auditing Profession: Western and Chinese Perspectives

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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.
- **Implications** for global structure of professional firms?

Research approach

- Literature etc.
- 30 semi-structured interviews / conversations in London, Hong Kong and Mainland China between 2011 and 2014
- Auditors, regulators, investors, academics
- Audit firms included Big 4; 2nd-tier international networks; 'independent' Chinese firms
- Questions adapted after 2012 'watershed' of expiry of Big 4 Joint Venture (JV) licenses and new 'localization' requirements

To understand the current
context,
we need to understand the
historical origination and
development that lies behind
it.....

The history of the origination and development of China's **audit firms**

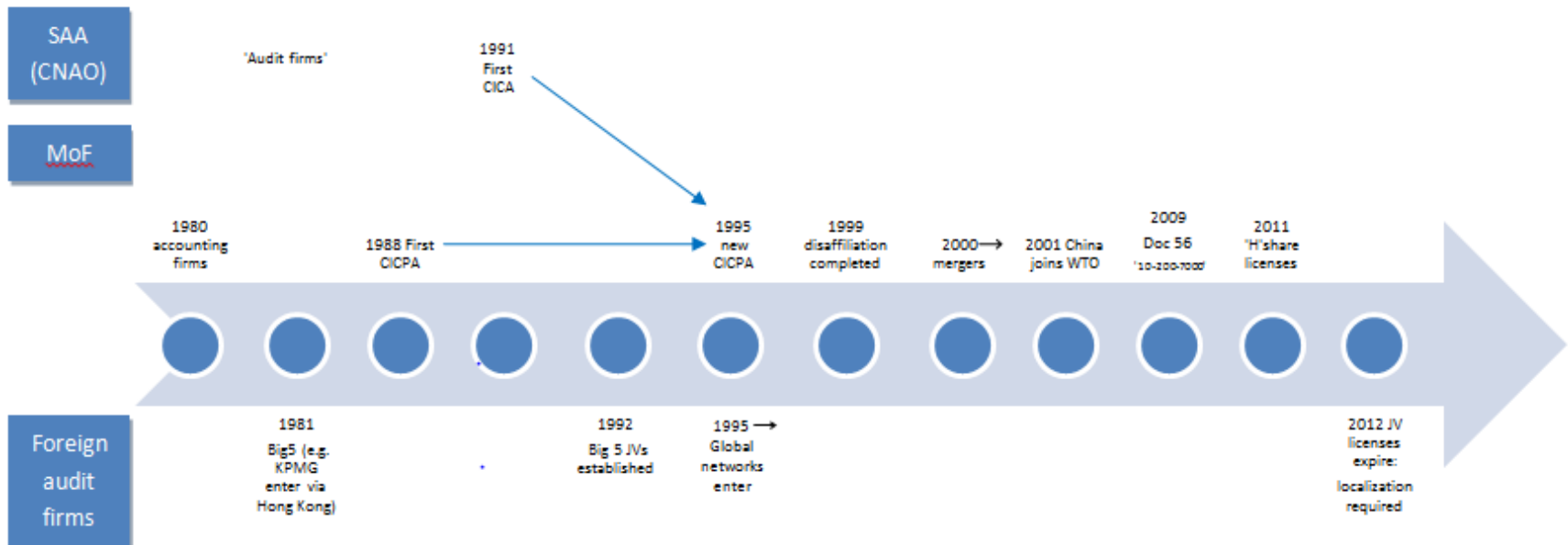
State audit

- Western Zhōu dynasty (1100-771BC)

Private audit industry

- Originated in 1920s
- Stagnated in 1956 under Mao Zedong
- Reconstructed in the 1980s under Deng Xiaoping's 'reform and open' policy
- Stages:
 - (a) first, bringing in foreign expertise;
 - (b) second developing the capability to challenge foreign competitors;
 - (c) third (and currently) turning the foreign competitors into 'Chinese' firms.
- (c) matches firms' own strategy but **disagree over speed....**

Indigenous and foreign firms in the stages of development of China's audit industry



Current context: MoF 'Doc 56' 2009

Current Context (1)

- *Audit market structure*
 - MoF target to set up a structure of ‘10-200-7000’. That is 10 ‘super’ indigenous audit firms with multinational operations that could service large comprehensive companies, 200 medium firms that could provide services for general listed companies, and 7000 small specialized audit firms focusing on their respective fields.

Home and overseas audit markets

cf. Automobile JVs and brands?

West must 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 More Stephens international network]
- 致同会计师事务所 *zhìtóng 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]

- 瑞华会计师事务所 *ruìhuá kuàijìshī shìwùsuǒ*

Ruihua Certified Public Accountants

[Formed by the 2013 merger of Crowe Horwarth China CPAs and RSM China CPAs (both of which had original 'H share' licenses)].

- 大信会计师事务所 *dàxìn kuàijìshī shìwùsuǒ*

Daxin Certified Public Accountants

[Member of PKF international network]

PLUS the Big 4 : *now under threat?* Have had to become SGPs and Chinese CPAs' control is being accelerated....

Context (2): *Service range extension*

- **Non Audit Services (NAS)**

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

.....

- **Accelerate transformation and upgrading**
- ***Concern about ‘independence’ issues (cf EU / US) not yet prominent*** (there are evolving rules about auditor rotation)

Context (3): *Professional competence*

- Originally: learn from the foreign partners
- Strategic role of universities and National Accounting Institutes
- Quality of CICPA exam regarded as high: can also now add ICAEW ‘Chartered Accountant’ (UK)
- Achieved ISA convergence and (nearly) IAS/IFRS
- MoF/CICPA encourage increasingly mature Chinese firms to take on work on their own (e.g. for alleged security reasons in major SOEs).
- Reciprocal relationships with international professional qualifications

Evaluation of the current situation

- In 2012 the Big 4 JV licenses expired. But there are still not enough **competent** indigenous audit firms that could provide auditing services for China's biggest cross-listed companies. However, Chinese firms are merging and also beginning to compete through consulting services for SOEs.
- Given only 20 years history, Chinese indigenous audit firms still cannot compete with the Big 4 (> 150 years history) in terms of **reputation** or **perceived independence from Government influence** (cf. ShineWing).

Evaluation of the current situation (cont.)

- Deng (2011) finds no evidence of improving risk control in the first 5 years following mergers of firms auditing domestic listed companies although Gong et al. (*TAR* 2016) find evidence of increased efficiency from mergers during 2005-2009.
- There have been recent PCAOB concerns about 'reverse takeovers' into US listing (***but*** cf. Lee et al. 2015).
- There have been disputes over PCAOB inspections of audit working papers in China.....

Evaluation of the current situation (cont..)

- The **risk control** procedures of many of China's indigenous audit firms (that handle most domestic IPOs) are not yet seen as mature. New clients bring the need to balance benefits against new audit risks, but **legal liability** risk is still low.
- However as firms exhaust growth by merger they are beginning to re-focus on quality signalling (e.g. ShineWing)
- Particularly important is the role of IAS/IFRS and ISA in enabling local firms to say they operate to the same standards.

The ambiguous role of IAS/IFRS and ISA?

- Historically, indigenous standards (currency, weights, road widths, etc.) in China originated with the first emperor, Qín Shǐhuáng (3rd century BC).
- Not all listed companies or indigenous audit firms yet fully understand and completely implement **international standards** (ISA and IAS/IFRS) and related **corporate governance** . Came *‘from heaven’*
- These standards have not grown from the specific history of China’s business environment, culture and ‘constellation’ of forces and institutions.
- Compare the experience of ‘translation’ of ISA into Russian audit practice (Mennicken 2008; 2010).

Some conclusions

- The historical background to the development of China's indigenous accounting profession and audit firms has created 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'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: in which they will soon become the **biggest firms....**

Some conclusions (cont...)

- These networks allow ‘independence’ of Chinese CPA firm with easier access to international quality control procedures, IFRS / ISA training, overseas experience, and value of international brand etc.
- Big 4 argued that ‘localisation’ from JV to local CPA dominated partnerships would evolve naturally (as e.g. in Europe) but partner promotions shouldn’t be rushed.
- MoF (2012) insisted: by 2017 will be max 20% non-CICPA partners and chairman of audit firm must be CICPA qualified.
- But wider management structure of ‘professional service firm’?
- Currently Hong Kong partners still dominate: face difficulties in taking CPA exams in Mandarin.

Some conclusions (cont...)

- MOF / CICPA have used 2012 JV license expiry to put pressure on Big 4 (whose domestic market share is declining) to localise more rapidly. Indigenous firms increasingly represented in CICPA hierarchy
- China now actively contributing to development of international standards through IASB and IAASB etc.
- Government influence also acts through SOE appointments and IPO authorisations (but CSRC still wants Big 4 auditors for major central state-owned financial institutions ...for now?).

Some conclusions (cont...)

- China's sheer size can change the world ranking of audit-consulting firms
- But can Chinese firms give up Chinese control and become truly 'international'?
- What will be **implications for world-wide structure of the profession** once the Chinese member firm is the largest in both Big 4 and 2nd-tier international networks? Can Anglo-American pattern still dominate?

Change is certain. But the *speed* of
change remains hard to predict
Watch this space....!!

For more...

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谢谢, 请多批评指正!

Xiè xiè, qǐng duō pīpíng zhǐzhèng!

*Thank you, please
criticise and correct as
much as possible!*