

Problems and Suggestions after the Merger of Chinese Local Accounting Firms

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Abstract

In view of the fact that Ruihua accounting firm received successive punishment from the regulatory level in 2016-2017, this paper discusses the reasons for the repeated punishment of the combined accounting firm from three aspects, namely, audit quality control system, external market and regulatory environment. In view of the above problems, this paper analyzes the problems that accounting firms should pay attention to after the merger from the aspects of corporate culture and values, internal quality control system, entrusted customer evaluation system, personnel recruitment and training mechanism, etc. At the same time, combined with the current regulatory environment, some suggestions are given.

Keywords

Chinese Accounting Firm, Merger, Audit Quality

1. Introduction

Ruihua Certified Public Accountants which ranks first in China's domestic firms and second in the comprehensive evaluation of 2016 earned more than 4 billion in revenue in 2016. It also ranked second in the industry, exceeding three of the "four largest in the world". At the same time, the number of Certified Public Accountants has more than 2500.

However, with the rapid development of Ruihua, its problems have become increasingly prominent. For example, after the merger, Ruihua failed to establish a unified quality control system. And in order to increase the scale of business, seize customer resources, increase market share, Ruihua sometimes has to meet some "special" requirements of the companies, which reduced the audit quality. From the middle of 2016 to the middle of 2017, Ruihua has received several

warnings and even penalties from regulatory authorities.

On June 21, 2016, Ruihua was publicly condemned by the Association of Interbank Dealers and was ordered to suspend its related business for one year. On July 28, 2016, Ruihua received a warning letter from the share transfer system due to irregularities in its audit report. On January 6, 2017, the China Securities Regulatory Commission issued the first ticket in 2017 and ordered Ruihua to correct the illegal act, confiscated of 390,000 yuan in income, meanwhile imposed a fine of 780,000 yuan; and the relevant certified public accountant was warned and punished by 50,000 respectively. On February 14, 2017, the relevant departments of the Ministry of Finance and the China Securities Regulatory Commission jointly issued a notice to temporarily revoke the qualification of Ruihua to undertake new securities business and rectify the deadline.

The repeated punishment not only caused Ruihua's reputation to be damaged, but also caused the loss of a large number of customers. What's more, it made the enterprises have doubts about the quality of the Chinese accounting firm's business. Try to imagine, Ruihua, as China's largest government, has received so many regulatory penalties. The actual situation of other small and medium-sized accounting firms is self-evident.

2. The Case Analysis

The series of events imposed by Ruihua has aroused the attention of the entire CPA industry in China. On the one hand, it exposes the shortcomings existing in the development of domestic firms. And to a certain extent, it fails to be diligent, and maintains the independence and objectivity of audit work. On the other hand, it also shows that China's supervisory authorities to strictly maintain the determination of market economy development. The scale expansion brought about by the merger of the firm is a good thing. Why does the level of auditing business not rise after the merger? What are the reasons behind the merger that have affected the accounting firm to become bigger and stronger?

2.1. The Accounting Firm Failed to Establish a Unified Quality Control System after the Merger

Behind Ruihua was repeatedly punished, Ruihua's own problems were the first reason to bear the brunt. In 2007, the original ZhongRui-Huahengxin and the original YueHua teamed together to establish ZhongRui-YueHua Accounting Firm. In April 2013, the original ZhongRui-YueHua and the original Guo-Fu-HaoHua teamed together to establish Ruihua Certified Public Accountants Co., Ltd. and became the domestic industry leader in China. After merge, there were 43 branch offices around the nation.

However, judging from the reasons for the penalty of Ruihua in this year, most of the direct fuses were problems left before the merger. Most of these businesses occurred before and after the merger of the practice team into Ruihua.

As we all know, the incidence of accounting firm practice risk is quite high before and after the merger.

After the merger, Ruihua became the largest accounting firm in the local country. At the same time, its business scale and income also surpassed the top four accounting firms in the world. Although on the one hand, the merger of Ruihua set an example for China's CPA industry to become bigger and stronger. However, on the other hand, the pace of this merger is too large, laying the hidden danger for the subsequent violation of the punishment.

After the merger, Ruihua must not only unify the practitioners in the organization, but also unify the financial, business, and information management aspects, especially in how to unify and standardize the management of the scattered offices. The various problems that emerged during the Ruihua incident exposed the lack of strictness in the merger process. Ruihua seems to be a unified group management, in fact it is different from each other, and the control of the audit quality is also inconsistent. Therefore, Ruihua has not formed a true integration in the implementation of the quality control system. It is also true in many aspects such as the management of human resources. In addition, based on past experience, many of the firms' auditing failures may have happened after the merger. This is due to the ignorance of risk control and the decline of resulting deterioration in audit quality. The inconsistency of quality control systems and professional standards is a major factor affecting audit quality. Prior to the merger, the two firms had different emphasis on the selection of customers, and also had different levels of control over audit quality [1] [2]. After the merger, as a brand new entity, Ruihua should provide a homogeneous service to all customers with a unified standard. Because the scale of the combined performance, the number of employees, and the size of customers have all expanded, [3] if Ruihua continue to use the previous quality control standards and regulations, it may find that auditing efficiency is reduced and Ruihua cannot meet the needs of customers. In addition, in the initial stage of merger, the internal governance of the firm will be relatively unsteady, and it will be easy to overlook the supervision of the practice quality during this period [4].

At the same time, the merged firm has not conducted effective defense and control over risk management, making the increase in the number of customers not matching with the growth in the number of capable signing certified public accountants. Therefore, it will have an impact on the assurance of audit quality.

2.2. Listed Companies Are the "Source" of Financial Fraud

In addition to internal problems in the internal integration of the accounting firm and the lack of internal supervision, the accounting firm is also affected by the external environment. In recent years, the number of listed companies in China has increased dramatically. Each major company needs to publish annual financial statements every year. If the company is in a loss for three consecutive years, it will face the risk of suspension.

Therefore, in order not to be suspended and thus affecting the operating conditions, some companies have increased the company's annual profits by fraudulently trading, fictitious income, and other financial frauds. As a third-party auditing accounting firm, on the one hand, it is required to publicly announce the audit results of the financial report. On the other hand, it is employed by the company to provide services for the company. In order to increase the scale of business, seize customer resources, increase market share, it sometimes has to meet some "special" requirements of the companies. The paper package cannot live fire over time. Finally, these things were eventually investigated by the regulatory agencies.

For example, in 2009 and 2012, the company, Key Bridge, suffered serious financial fraud through fabricating contracts to inflate sales revenue, cost and fictitious accounts receivable. Ruihua failed to do its duty, and issued an audit report with false records.

2.3. The Standard of Punishment for the Regulatory Agency Remains to Be Discussed

In recent years, the regulatory authorities have continuously strengthened the maintenance of the market economy's security development, especially against the capital market. As a result, the accounting agency, which is an important intermediary agency, has also been subject to rather strict supervision over its existing violations of laws and regulations. Penalties are also increasing. For example, in the case of Ruihua's suspension of securities qualifications at the beginning of 2017, the scale of punishment can be described as "a bowl of water is flat". Even if the number of securities clients in the firm varies greatly, they are all subject to the standard of "after two penalties in two years, the new securities business was suspended for two months". Although this may serve as a warning to a certain extent, it will inevitably cause certain large-scale firms to question: What are the standard and criteria for punishment? In addition, under the background of the increase in the number of listed companies mentioned before, is the system of "two-year two-single-one" fully considering factors such as risk factors and service scale? Can it be scientific, fair, reasonable and effective? This list of issues has yet to be revised and improved by the regulatory authorities in the future.

3. Advice and Suggestions for the Merger of Firms

As an independent third party, the firm not only needs to be accountable to customers, but also needs to be responsible for the majority of investors. Therefore, the first thing the firm needs to do is to start from "I" and continue to strengthen the quality of practice. Under the background of strict institutional guarantees, solid professional skills, and self-disciplined professional ethics, the firm needs to promise that each business will be able to stand up to the regulatory authorities and Market inspection [5].

First, the firm must form a distinct corporate culture and values. With the development and expansion of domestic firms in terms of size, business, income, and number of employees, large domestic firms such as Ruihua and Lixin can have already be comparable to general corporate firms, but they are not well known to the general public. However, they lack the proper corporate culture characteristics and corporate values that are well known to the general public. Similar to the Big Four accounting firms in the world, although they are all audit-related businesses, each firm has its own unique corporate values, such as Deloitte's integration with local "localization" and Ernst & Young's female care. On the one hand, the formation of a certain corporate culture and corporate values can guide the role of culture for internal leaders and employees, and morally strengthen the constraints on employees. On the other hand, firms can also attract specific corporate cultures to attract all outstanding talents, at the same time strengthen their influence in the society [6].

Second, strengthen the quality control system. As a new individual, the merged firm should implement a unified practice standard internally. As the saying goes, nothing can be accomplished without norms or standards. Only by establishing a set of standardized and effective practice standards, the firm can be better achieved the quality control. In the process of establishing a unified practice standard, the firm shall base on relevant laws, regulations and accounting standards in China, combine current development status and future strategic plans, and fully communicate and discuss with various personnel according to the actual conditions encountered in the practice process. Jointly study and formulate a set of more perfect and unified standards of practice. At the same time, after the standard setting is implemented, it is also necessary to make feedback changes from time to time. In addition, a set of corresponding supervision and management mechanisms must be established within the firm to ensure the smooth implementation of the practice standards.

Third, form a complete set of personnel training mechanism. Prior to the recruitment of new employees, especially for university students recruited on campus, they will be given training for a certain period of time. The content of the training is not limited to the work content that may be contacted in the future, but should also include training on professional ethics and professionalism. At the same time, for a large firm, it is necessary not only to employ professionals in financial auditing related professions, but also to recruit individuals with other professional abilities who are willing to engage in the auditing industry, such as legal profession, computer science, etc., to further improve the quality and efficiency of auditing work with these professional talents.

Fourth, establish an objective and impartial evaluation criteria for clients. After the merger, the number of customers accompanied by the growth of the firm has also increased significantly. However, the level of customers among them is uneven. So we need to establish a unified client evaluation standard internally to serve the company, and ensure that the firm maintains its independence. Re-

ducing auditing risks not only starts with internal personnel, but also requires careful investigation of the companies being audited before undertaking the auditing business. For those customers who are suspected of being fraudulent due to imperfect systems or weak internal controls, or because of limited audit conditions, capabilities, and scope, customers who are likely to fail the audit may be waived [7]. On the one hand, the establishment of a customer evaluation system can improve the auditing efficiency and make the auditing work more targeted, which helps the firm to better provide customers with quality services, and on the other hand also avoids the risk of blind auditing in order to increase business income.

Fifth, continue to strengthen external supervision. The punishment of the Ruihua's incident has sounded the alarm for the local large-scale firms in China. It also demonstrated the determination of the supervisory authorities to increase the supervision of relevant financial intermediary agencies including accounting firms. As important personnel for external oversight, the Certified Public Accountants Association, the China Securities Regulatory Commission, and even the public, shall promptly announce and impose corresponding penalties on all fraudulent frauds and improper audits. At the same time, the supervisory level also needs to impose certain penalties on the source of financial fraud—the related senior officials of listed companies. This two-pronged approach creates a good external regulatory environment for the orderly execution of China's financial markets [8].

4. Conclusions

It is the only way for the development of Chinese accounting firms to make bigger and stronger by merging. Also, the merged firm would face a lot of challenges. If those firms want to be bigger and stronger, they must fundamentally solve the potential problems, strengthen internal quality control management and risk prevention mechanism. The steady development of China's economy is dependent on the healthy development of the finance. And as the "raw material" of the financial information, the accounting information should be guaranteed by institutions like the accounting firm. So, the accounting firms, which are different from general companies, must be responsible for all the investors and assume certain social responsibility. As a result, Chinese accounting firms need to further strengthen internal management, increase the control of audit risk, and establish complete self-discipline mechanism to better serve the economic development of China.

At last, there are still some deficiencies in this analysis. The analysis is not sufficient, and there may be other external factors, which need to be further discovered.

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