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A Study in the Possibility of Establishing a  
Chinese ‘Big Four’ Group of Accounting  
Firms

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## **Abstract**

### Purpose

The purpose of this thesis is to describe and analyze the possibilities for China to create a socio-economic environment whereby the domestic accounting firms can compete with and even challenge the ‘Big Four’ accounting firms in Chinese auditing market.

### Methodology

The development of Chinese domestic accounting firms is reviewed and analyzed from macro and micro aspects including political and legal forces, economic forces, social culture, technological influences in society and so on. One hundred of the biggest accounting firms published by the CICPA (Chinese Institute of Certified Public Accountants) are chosen to be compared and analyzed in detail. All materials and analysis used in the thesis are quoted and based on the reports and figures from the official websites such as the CICPA, the Ministry of Finance and the National Office of Auditing.

### Conclusion

The thesis analyzes how realistic it is that the Chinese government aims of creating Domestic accounting firms capable of competing with the foreign companies in the future. According to our analysis of the developments of Chinese domestic accounting firms and Big Four in China in recent years, we find that the biggest domestic accounting firms have started to adopt concrete strategies to compete with the Big Four in China. The development of the auditing market and policies encouraged by the Chinese government, provide the feasibility to establish a competitive Chinese domestic ‘Big Four’ accounting firms in the future.

### Keywords

Domestic accounting firms, Big Four, Auditing market share, Venture out of China

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## List of Abbreviations

AICPA	American Institute of Certified Public Accountants
Big Four	International accounting firms, including Ernst & Young, Deloitte, PricewaterhouseCoopers and KPMG
CAO	China Aviation Oil Ltd.
CAPA	Confederation of Asian and Pacific Accountants
CCB	China Construction Bank
CICPA	Chinese Institute of Certified Public Accountants
CPA	Certificated Public Accountant
CSRC	China Securities Regulatory Commission
ERP	Enterprise Resource Planning
IASB	International Accounting Standard Board
IFAC	International Federation of Accountants
ICBC	Industrial and Commercial Bank of China
MOF	Ministry of Finance
NAO	National Audit Office
NPC	National People's Congress
SAP	Systems Applications and Products
SASAC	State-owned Assets Supervision and Administration Commission of the State Council
SINOPEC	China Petroleum & Chemical Corporation
UFIDA	The Biggest ERP Company in China Listed in Shanghai Exchanges
WTO	World Trade Organization

## I. Introduction

### *I.1 INTRODUCTION*

Audit, as defined in the 1989 Seminar on Fundamental Audit Theories in China, are "independent activities of economic supervision over the truthfulness, compliance and effectiveness of the revenues and expenditures and other relevant economic activities of the audited bodies by professional organizations and individuals for the purpose of evaluating economic accountability, maintaining financial and economic laws and regulations, improving business management, upgrading value for money and promoting macroscopic readjustment".

Since the establishment of the *Certified Public Accountant* (CPA) in China more than 20 years ago, the CPA profession has developed quickly to the present day. CPA has been playing a more prominent role in the Economy and people's daily life. Since the Chinese government softened the terms for approving accounting firms and China entered the WTO, more and more Chinese (local) accounting firms as a consequence have been established. Meanwhile, the Big Four accounting firms, Deloitte, PricewaterhouseCoopers, Ernst & Young and KPMG, have been opening offices in China as well, using their brand advantage to enlarge their market share. Thus, we believe that, there was, is and will continue to be a cutthroat type of environment among accounting firms in China. Therefore, the first and foremost priority for those local accounting firms is to survive and become profitable. Finding the proper position in the auditing industry and making effective market strategies that utilize competitive advantages is even more important now.

In the 1990's, **the Big Five, which are Deloitte, PwC, Ernst & Young, KPMG and Arthur Andersen**, successfully entered into Chinese audit market one after the other. They Chinese government allowed them to set up joint venture accounting firms in China. Later, Arthur Andersen was involved in the scandal at Enron, which lead to

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AA's bankruptcy. Thus, the Big Five became the Big Four. From the beginning of the 20<sup>th</sup> century, China has had a rapidly developing economy. The auditing and consulting market also expanded as a result of this economic expansion. At the time, the demand for auditing reached unheard-of levels. In 2001, some Chinese accounting firms were involved in a series of big scandals. The "YingGuangXia", "ZhengBaiWen", and "LianTian" scandals were three of the biggest. This prompted the Chinese Stock Supervisory Committee to issue an "Additional Audit (16)" (CSRC 2001, No. 161). This article requires the listed company to be additionally audited by international accounting firms after being audited by domestic accounting firms concerning the issue of IPO or the need for re-financing. Some banks had also stipulated that companies which are lending money are required to make a credit audit by appointed foreign accounting firms. These companies include government authorities, the finance sector and local government. At the end of 2004, Shenzhen (One of the biggest local governments in China) required all state-owned enterprises of base industries should be audited by the Big Four. With these preferential Local government policies, the Big Four expanded fast in China. (Jiang 2007)

Every year, the Chinese Institute of Certified Public Accountants (CICPA) will issue the information and place of the first one hundred accounting and auditing firms. Table 1 shows the turnover of the Big Four firms in Year 2002 and 2008. According to the statistics by the CICPA of the top one hundred accounting firms in 2003, the Big Four's turnover in 2002 accounted for 36.98% of the total turnover of the first one hundred firms. And in 2008, the Big Four accounted for 51.24%, which was calculated by CICPA in the year 2009. The Big Four firms have monopolized all business and listed enterprises in China, and almost have monopolized Chinese high-end accounting and auditing business. While some banks such as Industrial and Commercial Bank of China (ICBC), China Construction Bank (CCB), and Industrial and Commercial Bank of China (ICBC) went directly into the Big Four with millions of auditing and consulting fees, more than 56 thousand Chinese domestic accounting



firms were fighting over the scraps from the Big Four table.

Table 1 the turnover of the Big Four in Year 2002 and 2008

	Year 2002		Year 2008				
	Turnover (billion ¥)	% of the first 100 firms	Turnover (billion ¥)	% of the first 100 firms	Audit fee (billion ¥)	% of the first 100 firms	Audit fee/ Turnover
<b>PwC</b>	0.77	17.30%	2.76	14.01%	2.61	16.53%	94.72%
<b>KPMG</b>	0.33	7.55%	2.70	13.73%	2.26	14.33%	83.80%
<b>Deloitte</b>	0.29	6.58%	2.50	12.71%	1.70	10.78%	68.21%
<b>Ernst &amp; Young</b>	0.25	5.56%	2.43	12.38%	1.54	9.76%	63.26%
<b>Total Big Four</b>	1.64	36.98%	10.39	52.83%	8.12	51.42%	-
<b>Total 100 firms</b>	4.43	-	19.67	-	15.79	-	80.27%

Information published in 2003 and 2009 by the CICPA

Ever since the advent of foreign accounting firms into the Chinese market; Government/Local government and industry has had very little confidence in domestic accounting firms. They worship the Big Four and want to get help from the Big Four's so called "excellent reputation" both in domestic and foreign markets to enhance their own status. However, the practice of auditing has failed to show any evidence that the Big Four were able to provide an auditing service with higher degree of quality. Early in the 2001, KPMG had been criticized by Chinese Ministry of Finance because of the distortion of financial statements of China Petroleum & Chemical Corporation (SINOPEC), Henan branch and Guangxi Yuchai Machinery Co., Ltd. Ernst & Young was being widely criticized by the risk handbook of China Aviation Oil Ltd. (CAO). In 2006, Ernst & Young published "the report of non-performing loans" worldwide, which had been taken back because Ernst & Young recognized that there was no foundation in fact according to the estimation of non-performing loans. In the announcement of Chinese Ministry of Finance in 2005, KPMG was asked to rectify and improve the ranking one listed company called

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Huangshan Traveling. After that, KPMG was sued for investigating audit responsibility for a large amount of indemnity by Shanghai Wai Gaoqiao Free Trade Zone Development Co. Ltd Deloitte was criticized for “KeLone” because of a similar auditing oversight, because the audit procedures were not adequate on inventory, receivables, and turnovers. (CICPA, No.2007-3)

Chinese government has now realized the problems that exist in the Chinese audit profession, and also the fact that Chinese audit market almost has been monopolized by foreign accounting firms. In our paper, we want to analysis the macro and micro environments of the Chinese auditing profession as well as the auditing market by using PEST and Porter’s methods. We will compare strengths, weaknesses, opportunities and threats between The Big Four firms and the larger Chinese accounting firms as our case study for the purpose of finding the gap between Chinese local accounting firms and the Big Four. (Jiang 2007)

## ***1.2 PROBLEM STATEMENT***

This master thesis is aimed at analyzing how realistic it is that the Chinese government aim to create local Chinese Big Four accounting firms. In order to find this, we need to analyzing how the macro and micro environments affects to build and strength Chinese local accounting firms, which are ready and looking forward to challenge the Big Four in the field of auditing in China. We have chosen two Chinese local big accounting firms as our case to examine this. The reason for Chinese local accounting firms can compete with the Big Four mainly lies in Chinese audit environments, which we are going to look into. It has been a fact that the Big Four firms have already dominated the international accounting area, especially related to audit marker. It is a great thing that Chinese government and accounting firms want to challenge the position of the Big Four in Chinese audit market.

For this reason, we formulate our problem statement in the following way:

How realistic is it that the Chinese governments aim to create local Chinese Big  
Four accounting firms by replacing the Big Four in China?  
A case study of comparison of the Chinese big local accounting firms and the Big  
Four firms in China.

In order to approach this topic in an efficient way, we have further formulated three questions, which will help us to seek answers deeply. Besides, the comparison of Chinese big local accounting firms and the Big Four firms will provide us with further inside to the intense competition and the power of Chinese government in the field of audit market, and further to get our answer related to our topic.

These questions are:

1. What are the environments (macro and micro) of Chinese audit market contribute to build local firms?
2. What is the position of the Big Four firms in Chinese auditing market?
3. How do Chinese big local accounting firms develop?

“Today, investors and large companies increasingly bemoan the lack of choice that pervades the international accounting industry, particularly in the area of multinational audits. As they find themselves forced to use one of the Big Four for the audit...” (Lafferty 2007)

It is become the problem that there are only four big accounting firms that dominant audit markets throughout the world. The Chinese government has responded by using its power to encourage building local accounting firms, and even to set up its own “Big Four” in China. We believe it is interesting to find out whether it is realistic to build “Chinese-made Big Four”. And if the answer is yes, China would be a good example for other countries to follow.

The remaining part of this paper is structured in the following way. Chapter II will develop the frame of reference that consists of the PEST Analysis Theory, Michael Porter five forces theory, and SWOT analysis theory. Chapter III will describe the methodology understanding of our research in looking at the research design, and how data was collected. Chapter IV analysis the macro environments of Chinese audit market by using PEST analysis, while Chapter V analyses the micro environments of Chinese audit market by using Michael Porter Five Forces Model. Chapter VI then compares the data we got between Chinese local big accounting firms and the Big Four. Finally, Chapter VII will not only conclude the findings we got of this thesis, but also give a future prospect to study this topic.

## II. Frame of reference

### II.1 PEST ANALYSIS

In Section IV, we will analysis the microenvironments by using PEST Analysis, which can be expressed in terms of the following factors: Political (P), Economic (E), Social(S) and Technological (T). The following table we list some factors which should be considered according to PEST Analysis. (QuicKMBA.com, “PEST Analysis”; NetMBA.com, “PEST Analysis”)

Table 2 Subjects for PEST Analysis

<b>Subjects for PEST Analysis</b>	
<p><b>Political</b>            ecological/environmental issues            current legislation home market            future legislation            European/international legislation            regulatory bodies and processes            government policies            government term and change            trading policies            funding, grants and initiatives            home market lobbying/pressure groups            international pressure groups            wars and conflict</p>	<p><b>Economic</b>            home economy situation            home economy trends            overseas economies and trends            general taxation issues            taxation specific to product/services            seasonality/weather issues            market and trade cycles            specific industry factors            market routes and distribution trends            customer/end-user drivers            interest and exchange rates            international trade/monetary issues</p>
<p><b>Social</b>            lifestyle trends            demographics            consumer attitudes and opinions            media views            law changes affecting social factors            brand, company, technology image            consumer buying patterns            fashion and role models            major events and influences            buying access and trends            ethnic/religious factors            advertising and publicity            ethical issues</p>	<p><b>Technological</b>            competing technology development            research funding            associated/dependent technologies            replacement technology/solutions            maturity of technology            manufacturing maturity and capacity            information and communications            consumer buying mechanisms/technology            technology legislation            innovation potential            technology access, licensing, patents            intellectual property issues            global communications</p>

Information collected through QuicKMBA.com, “PEST Analysis”; NetMBA.com, “PEST Analysis”

## II.2 MICHAEL PORTER FIVE FORCES MODEL

In Section V of our thesis, we will analysis the microenvironment of accounting firms in China using Porter's five forces, which is a model for industry analysis. This model provided a framework that models an industry as being influenced by five forces, which is rivalry, threat of substitutes, buyer power, supplier power, and barriers to entry. (See Figure 1) ( Porter 1980)

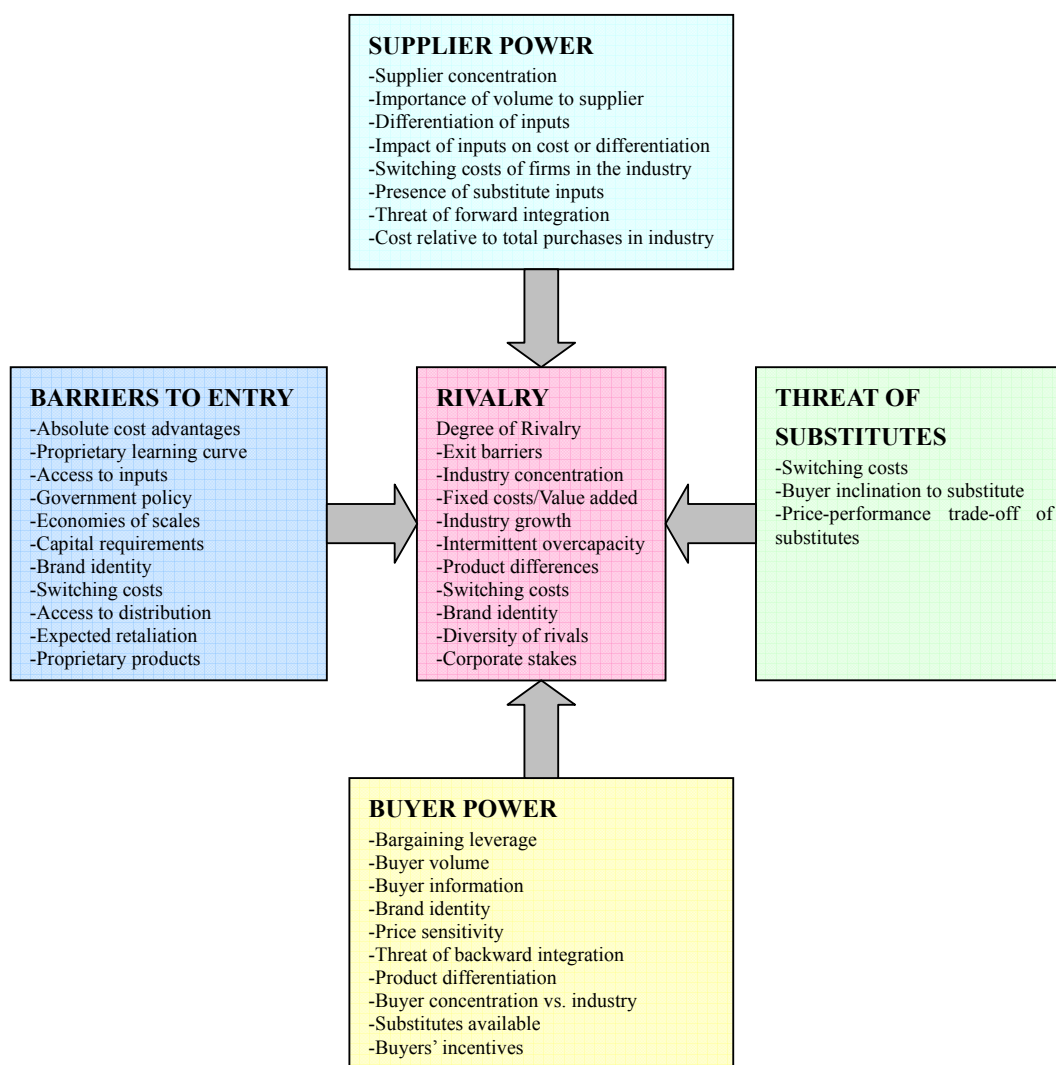


Figure 1 Porter's Five Forces

Information collected through Porter 1980

### 1. Rivalry

In the traditional economic model, competition among rival firms could drive profits to zero. But competition is not perfect and firms are not unsophisticated passive price takers. Rather, firms strive for a competitive advantage over their rivals. For most industries, this is the major determinant of the competitiveness of the industry. Sometimes rivals compete aggressively and sometimes rivals compete in non-price dimensions such as innovation, marketing, etc.

If rivalry among firms in an industry is low, the industry is considered to be disciplined. This discipline may result from the industry's history of competition, the role of a leading firm, or informal compliance with a generally understood code of conduct. When a rival acts in a way that elicits a counter-response by other firms, rivalry intensifies. The intensity of rivalry commonly is referred to as being cutthroat, intense, moderate, or weak, based on the firms' aggressiveness in attempting to gain an advantage.

The intensity of rivalry is influenced by the following industry characteristics:

- **A large number of firms** increase rivalry because more firms must compete for the same customers and resources.
- **Slow market growth** causes firms to fight for market share. In a growing market, firms can increase revenues simply by enlarge market.
- **High fixed costs** result in an economy of scale effect that increases rivalry.
- **Low switching costs** increases rivalry. When customers can easily and freely switch from one service provider to another, there is a greater struggle to capture customers.
- **Low levels of product differentiation** absolutely increase rivalry. On the other hand, brand identification can constrain rivalry.
- **Strategic stakes are high** when a firm is losing market position or has potential for great gains. This intensifies rivalry.

- **High exit barriers** make firms must compete, because the cost is high if firms abandon their products/service.
- **A diversity of rivals** - different histories, or cultures etc– could make the market unstable. Thus, rivalry could be volatile and intense.
- **Industry shakeout** could lead to slow growth rate and the market becomes saturated, which will increase rivalry.

## 2. Threat of Substitutes

The existence of close substitute products/service increases the propensity of customers to switch to alternatives in response to price increases. Besides the threat of substitutes typically impacts an industry through price competition, there could be other concerns in assessing the threat of substitutes:

- **buyer propensity to substitute**

Despite the benefits, like lower price etc, offered by the substitute product or service, we shall ask whether people really want it.

- **buyer switching costs**

High switching costs decrease the threat of substitutes.

- **perceived level of product/service differentiation**

In Porter's model, substitutes refer to products/service in other industries. Thus, there should be differentiation among different products/service. High perceived level of products/service differentiation decrease threat of substitutes.

## 3. Buyer Power

The power of buyers is the impact that customers have on an industry. When buyer power is strong, the relationship to the producing industry is near to a monopsony, which means there are many suppliers but few buyers. Under such circumstance, the buyers set the price. There are some factors impacting buyer power:

- **Buyers are powerful if:**

Buyers are concentrated – there are a few buyers with significant market share



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Buyers purchase a significant proportion of output  
Etc.

- **Buyers are weak if:**

Significant buyer switching costs

No buyer has any particular influence on products/service or price

Etc.

#### **4. Supplier Power**

Also this can be described as market of inputs. Suppliers of raw materials, components, labor, and services (such as expertise) to the firm can be a source of power over the firm. Suppliers may refuse to work with the firm, or e.g. charge excessively high prices for unique resources. The following outline some factors that impact supplier power.

- **Suppliers are powerful if:**

Credible forward integration threat by suppliers

Suppliers concentrated

Significant cost to switch suppliers

Customers powerful

- **Suppliers are weak if:**

Many competitive suppliers – products/service are standardized

Credible backward integration threat by purchasers

Concentrated purchasers

Customers weak

#### **5. Barriers to Entry / Threat of Entry**

Profitable markets that yield high returns will draw firms. This results in many new entrants, which will effectively decrease profitability. Unless the entry of new firms can be blocked by incumbents, the profit rate will fall towards a competitive level. Some of an industry's entry and exit barriers can be summarized as the following:

Table 3 Barriers to entry

<p><b>Easy to enter if there is:</b></p> <ul style="list-style-type: none"> <li>• Common technology</li> <li>• Little brand franchise</li> <li>• Access to distribution channels</li> <li>• Low scale threshold</li> </ul>	<p><b>Difficult to enter if there is:</b></p> <ul style="list-style-type: none"> <li>• Patented or proprietary know-how</li> <li>• Difficulty in brand switching</li> <li>• Restricted distribution channels</li> <li>• High scale threshold</li> </ul>
<p><b>Easy to exit if there are:</b></p> <ul style="list-style-type: none"> <li>• Salable assets</li> <li>• Low exit costs</li> <li>• Independent businesses</li> </ul>	<p><b>Difficult to exit if there are:</b></p> <ul style="list-style-type: none"> <li>• Specialized assets</li> <li>• High exit costs</li> <li>• Interrelated businesses</li> </ul>

### ***II.3 SWOT ANALYSIS***

SWOT can be expressed in terms of the following factors: Strengths (S), Weaknesses (W), Opportunities (O) and Threats (T). In Section VI, we will pick three accounting firms in China, using this method to compare and analysis their strengths, weaknesses, opportunities and threats. By using this method, we shall concern the following subjects. (See Table 5) (QuickMBA.com, “SWOT Analysis”; NetMBA.com, “SWOT Analysis”; Mind Tools, “SWOT Analysis”)

Table 4 Subject of SWOT Analysis

<b>Subjects of SWOT Analysis</b>	
<p><b>Strengths</b></p> <p>Advantages of proposition?            Capabilities?            Competitive advantages?            USP's (unique selling points)?            Resources, Assets, People?            Experience, knowledge, data?            Financial reserves, likely returns?            Marketing - reach, distribution, awareness?            Innovative aspects?            Location and geographical?            Price, value, quality?            Accreditations, qualifications,</p>	<p><b>Weaknesses</b></p> <p>Disadvantages of proposition?            Gaps in capabilities?            Lack of competitive strength?            Reputation, presence and reach?            Financials?            Own known vulnerabilities?            Timescales, deadlines and pressures?            Cash flow, start-up cash-drain?            Continuity, supply chain robustness?            Effects on core activities, distraction?            Reliability of data, plan predictability?            Morale, commitment, leadership?            Accreditations, etc?</p>

certifications? Processes, systems, IT, communications? Cultural, attitudinal, behavioural? Management cover, succession?	Processes and systems, etc? Management cover, succession?
<b>Opportunities</b>  Market developments? Competitors' vulnerabilities? Industry or lifestyle trends? Technology development and innovation? Global influences? New markets, vertical, horizontal? Niche target markets? Geographical, export, import? New UPS's? Tactics - surprise, major contracts, etc? Business and product development? Information and research? Partnerships, agencies, distribution? Volumes, production, economies? Seasonal, weather, fashion influences?	<b>Threats</b>  Political effects? Legislative effects? Environmental effects? IT developments? Competitor intentions - various? Market demand? New technologies, services, ideas? Vital contracts and partners? Sustaining internal capabilities? Obstacles faced? Insurmountable weaknesses? Loss of key staff? Sustainable financial backing? Economy - home, abroad? Seasonality, weather effects?

Information collected through QuickMBA.com, "SWOT Analysis"; NetMBA.com, "SWOT Analysis"; Mind Tools, and "SWOT Analysis"

#### ***II.4 AUDIT HISTORY***

China has a long audit history, which can be traced back to the legend about King Yu the Great when he met his vassals in Kuaiji in Xia Dynasty (21st - 16th century BC), and records from oracle bones about activities with audit nature in Shang Dynasty (16th - 11th century BC). As early as the Western Zhou Dynasty (11th century BC – 771 BC), supervision of an auditing nature over public finance and economy had already emerged. The historical development of audit profession in China was closely related to government administration. Audit played a very important role in anti-corruption, maintaining the imperial power and social stability as it does today. (Hu, S)

In 1912 the year the Republic of China was founded was somewhat of a watershed for auditing methods in China. It distinguished the modern method of audit from the previous archaic methodology. After 1912, special audit institutions and audit

law/regulations emerged. During most of the time before 1912, there were usually no special audit institutions and full-time professionals to conduct audits. Audit was usually combined with another job, e.g. government censorate, financial management, etc.

In early 1927, the government of the Republic of China issued the Constitution of Certified Public Accountants which indicated that the Ministry of Finance was in charge of accountants and related regulations. Subsequently, the Accountant Constitution and Accountant Statute were published by the Ministry of Industry and Commerce and the legislative Yuan. By 1949, there had been around 3000 CPA in China under the administration of Kuomintang. After the Chinese Communist Party came into power in 1949, they implemented a Socialistic Economic reconstruction in economy. This implementation was completed in 1956 and the so called 'planned economic system' was created. From that time, the development of CPA was intermittent in China. (Memorabilia of Chinese CPA, 2008)

After '*the Cultural Revolution*', the focus of China's development was focused on the economy again. Chinese government called for economic reform especially. During that period, China's main task was to bring the National Economy back to a stable Economic footing. It was in principle decimated during the Cultural Revolution from 1966 to 1976. China was anxious to get investments from overseas in early 1980s. Whether it be importing investments or establishing joint-venture enterprises, financial information had to be exchanged. However accountants had no idea what kinds of financial information ought to be prepared for Overseas Investors. Even though there was financial information available it didn't did not correspond with accepted financial standards from abroad. There had been millions of accountants in China at that time. They were trained under the accounting system of the former Soviet Union. There had not been qualified CPA in China for long time, let along related professions. In was with this background, in December 1980, which the

Ministry of Finance issued the Temporary Regulations on Establishing Accounting Consulting Department. The system of accounting and CPA was rebuilt. (CICPA, No. 2008-8)

With the publications of series of laws regarding accounting and accountants in the following years, Chinese accounting standards and regulations have been developed toward to international accounting standards. In 1997, the Chinese Institute of Certified Public Accountants (CICPA), founded in 1988, was accepted as the member of IFAC, CAPA and IASB. By cooperation with international organizations, China increased the processes of International accounting and auditing convergences domestically. This convergence was especially important when china became a member of the World Trade Organization (WTO), China had to fulfill the required obligations for membership notwithstanding the financial sector. China would allow international accounting and accounting firms to launch businesses in China. These firms would be subject to the same rights and regulations as the Domestic Firms. (CICPA, No. 2005-10, P11 to P14)

### ***II.5 AUDIT CULTURE***

In Zeff's article (Zeff, 2007), he introduces the auditing culture and related influence in western countries. He discusses how the understanding of accounting and auditing regulations like FIFO and LIFO and depreciation, differs from countries because of cultural or conceptual differences. It shows that the cultural influences in accounting and auditing conception and even the implementations of standards cannot be ignored.

For our thesis, we introduce briefly the Chinese cultural factor influencing the independence and objectivity of auditing to a certain extent. In China, getting to know new friends (business partners) is deemed just as an important premise as making a successful business venture. For example, a restaurant is the preferred place to get to know new friends because of the relaxing atmosphere and naturally having informal

discussions about business. With regard to auditing, the audited company always wishes to get a good auditing report which can facilitate the public interests of the company. For this reason, it is very common for the audited company, that is to say the client, to welcome an accounting firm with a welcoming ritual. This is not bribing as such but can be loosely described in English as 'Goodwill' In Chinese it is to establish Guan Xi with each other. Guan Xi means good relationship and trust between client and contracted company or partner, which exists in every aspect of society in Chinese culture.

It is a problematic situation for the accounting firm to deal with the cultural principle of Guan Xi with respect to the client and at the same time not transgresses one of the auditing principles. This dilemma in keeping the independence and objectivity of auditing while respecting the cultural ritual of Guan Xi is for the Auditing firm contradictory because they would obviously prefer not to offend the client and be re-employed again as the Auditing firm. If the Audited company has accounting irregularities however, this 'Guan Xi relationship leads to a 'conflict of interests' which is not always easily reconciled.

Domestic accounting firms are of course familiar with these principles of keeping Guan Xi with the clients on the premise that laws and standards should be adhered to. In China, the Big Four employs large numbers of Chinese CPAs and staff. The upper management levels or senior managers are exclusively from America or European countries. In other words although the Big Four, themselves despite having a different cultural business/auditing background they will also follow the Chinese tradition which includes having good Guan Xi with clients. Otherwise their market share would probably be decreased.

In 2001, the CSRS imported the double checking system of as one of the auditing methods for the Big Four foreign companies to use as a guarantee of auditing

authenticity for because CSRS knows that the cultural effects on auditing has previously had negative influences on Chinese auditing in the market place and that it has consequently impaired the independence and even authenticity of auditing reports for listed companies. Since the CSRS introduced the new auditing concepts, Domestic accounting firms have adopted the concepts in their auditing. At the same time the Big Four global firms have been involved in auditing scandals in China (to be will be discussed in PEST analysis). The reputations of the Big Four have come under criticism. High auditing fees (Four times higher than local firms) are criticized for not matching it with auditing quality. Some listed companies have replaced the Big Four with Domestic accounting firms. More opportunities have arisen for Domestic firms. The Big Four are facing two choices: Compete on 'equal' cultural terms as the Domestic firms, and jeopardize objectivity or, highlight reputation and quality by less emphasis on the basic principles of Chinese business etiquette to insist on real independence and retain objectivity in auditing. (Guangzhou Audit, 2008)

## ***II.6 AUDIT MARKET***

In China, both accounting work and auditing work are done by accounting firms. There are presently more than 4000 accounting firms, 71 of which are certified auditors. In our paper, we use the word accounting firms to represent those accounting firms who are qualified in auditing. We also focus on those Chinese accounting firms that have the capacity to compete with foreign accounting firms in this paper.

We have divided the Chinese Domestic market for auditing into four parts:

- 1. Companies being or going to be listed in China**
2. Companies being or going to be listed in Hong Kong
3. Companies being or going to be listed aboard
4. Domestic companies not listed or going to be listed

In our paper, we define our audit market only including companies being listed or

going to be listed on the Chinese stock market. And the figures we use in this paper are only related to Chinese local market. However, these figures in our paper, e.g. the turnovers of accounting firms, do not only refer to the business of auditing, but also include other services provided by these accounting firms, e.g. consulting and tax advice.

In the Chinese audit market, there are only four foreign accounting firms, which are called the Big Four firms – KPMG, Deloitte, Ernst & Young and PwC. The other accounting firms in China are all domestic Chinese firms.

As mentioned above, in the year 2001, the Chinese Stock Supervisory Committee issued “Additional Audit Article 16”. This article requires the listed company to be subject to an additional audit by one of the international accounting firms after being audited by a domestic accounting firm when it is concerning the issue of IPO or the need for re-financing. Some banks have also stipulated that listed companies are required to take a credit audit by an appointed foreign accounting firm. These rules no longer exist today. There are no requirements for listed companies relating to which accounting firm the company has to choose, which means Chinese Domestic accounting firms can do their auditing service independently. This has led to a more competitive market where the Foreign and the larger Domestic accounting firms. It's these competitions between the Big Four firms and Chinese accounting firms which we intend to focus on. (Jiang 2007)

## ***II.7 THE BIG FOUR GLOBAL ACCOUNTING FIRMS***

This group was once known as the "Big Eight" in 1960s. As time went on, a series of mergers among accounting firms reduced the number of big firms. Since PricewaterhouseCoopers was formed in the 1998, the Big 5 came into being. Later, Arthur Andersen was involved in the Enron Scandal, which led to AA's bankruptcy. Thus, the Big Five became the Big Four. (Jiang 2007) None of these Big Four is a



single firm. Each of them is a network of firms, owned and managed independently. Table 2 shows the revenue and employees of the Big Four worldwide. According to the report by Government Accountability Office (GAO), the Big Four audit 98 percent of the more than 1500 largest companies, and dominant the international audit market. GAO admitted that the concentration within the audit firms had been a problem. (GAO 2003)

Table 5 The data of the Big Four in Year 2008

Fiscal year: 2008

Firm	Revenues	Employees
PricewaterhouseCoopers	\$28.2bn	155,693
Deloitte Touche Tohmatsu	\$27.4bn	165,000
Ernst & Young	\$24.5bn	135,000
KPMG	\$22.7bn	137,000

Information published on the website of PricewaterhouseCoopers, Deloitte Touche Tohmatsu, Ernst & Young and KPMG in 2009

The Big Four are widely held perception that competition regulators are unlikely to allow any further concentration of the accounting and auditing industry and that other firms (BDO International is the fifth largest) will never be able to compete with the Big Four for top end work as there is a market perception that they are not credible as auditors or advisors to the largest corporations.

As well as in the other countries, The Big Four in China have also controlled the whole accounting and auditing markets. However, the Big Four in China as well as any other countries in the world have been involved in kinds of scandals, such as the issue of Jin Zhou Port by KPMG in 2001, China Aviation Oil by Ernst & Young in 2004, Kelon by Deloitte in 2005 and Huang Shan Travel by PwC in 2005. And the concentration of audit profession has been recognized as a big problem. Investors, companies, regulators etc. have complained about lack of choice but the Big Four

firms. For these reasons above, it is useful and interesting to find out whether it is possible to create Chinese own 'Big Four' group of accounting firms.

### **III. Methodology**

This chapter is to describe the approach of studying the problem statement and three questions prepared in the first chapter. For that reason, we will look into the design, data collection and evaluation.

#### ***III.1 RESEARCH APPROACH***

Before going into more detail about the specific research design, it is important to describe the main concepts used in this master thesis. Every researcher has to define how he/she will organize the research activities and what sources and methods will be used during the process of gathering data. It is also essential for the research approach to be in line with the philosophical positioning of the researcher because a clear strategy facilitates to deal with every aspect of the research and also in regard to the changing context throughout the whole process. (Mason 2004)

We have thus chosen to an abductive research as a tool to applying the relevant theories in this master thesis. The abductive approach is influenced by both induction and deduction.

In order to get a better understanding of this approach it is helpful to describe the inductive and deductive approach. Deductive research represents the commonest view of the nature of the relationship between theory and research. The researcher, on the basis of what is known about a particular domain and of theoretical considerations in relation to that domain, deduces a hypothesis that must then be subjected to empirical scrutiny. (Bryman & Bell, 2003) the whole process is also seen as moving from the more general to the more specific and concrete view.(Punch 2005) The inductive approach differs from the deductive approach since it is conducted without any former expectations in order to get a fair view of the field. With this open-minded approach, relevant theories are formulated after the empirical information gathering. This approach is thereby suggested to minimize the risks of losing valuable information. (Bryman & Bell, 2003)

During the research process, the empirical standpoint is gradationally progressed and theory refined. The abductive method allowed us to alternate between the theoretical frame of reference and our empirical findings. It enabled us to capture both empirical facts and theoretical understandings. This master thesis will focus on using qualitative sources for gathering data. With the help of these methods, we will be able to apply the theories of chapter two and to analyse them in regard to our problem statement.

### ***III.2 RESEARCH DESIGN***

The design of this thesis is influenced mainly by the chosen topic and how much empirical data is available for collection. In this case, we have chosen to research the possibility of establishing a Chinese ‘Big Four’ group of accounting firms. Then, we formulated three sub-questions in order to get enough information to solve this problem statement. Thus, we will firstly draw a picture of the situation of Chinese audit market and secondly explore whether it is possible for China to build its own ‘Big Four’ accounting firms. It is essential to start with describing Chinese audit market as well as the global Big Four accounting firms before we explore why China needs its own ‘Big Four’. The audit market in China is quite complicated because it is influenced by a lot of factors and so far not known to outsiders. This will provide basic understanding for readers. Then we use the PEST Analysis to describe and research the macro environment of Chinese accounting firms. In this part, the characters and situations of Chinese accounting firms are discussed from aspects including political influence, legal system, economic development, scale of CPA business, social value conception, CPA profession and use of computer in auditing in China. Thirdly, we use Michael Porter Five Forces Model to analyze the pros and cons of this firm and its surroundings.

Besides above, we choose two local Chinese accounting firms to compare with the Big Four in China. All the firms are chosen from the Top 100 Accounting Firms report 2008 issued by the Chinese Institution of the Certified Public Accountants (CICPA) in April 2009. By the comparison, we want to find the disparity of local Chinese accounting firms with the global Big Four, and the possibility for China to create its own ‘Big Four’.

In this thesis, we have chosen to use a qualitative method because instead of quantitative method in order to collect relative information that this thesis needs. ‘Qualitative data is not restricted to formal or fixed rules but consist a variety of things. Examples are interview transcripts, documents, observational records and notes, audiovisual materials or personal experience notes like artefacts, journals and narratives. Duo to this wide range of possibilities, qualitative researchers usually do not restrict themselves to only one data collection method. They use multiple data sources because the more data is collected from different sources, the more valid and reliable the research will be seen as. It is without any question more difficult for qualitative researchers to decrease the danger of human error and bias but only observations and interviews can provide the necessary insight into human behavior.’ (Punch 2005)

To sum up, qualitative method is more proper for our thesis. To find out the answer to our problem, it is necessary to understand the audit market, culture, and environment.

### ***III.3 DATA COLLECTION METHOD AND EVALUATION***

‘The basis of qualitative research consists thereby of primary and secondary data which can furthermore be divided into various techniques, like interview, observation, experiences, documents and so on. Primary data is the collection of new and original information whereas secondary data consists of collection of existing sources, like books, reports from governments, or documents.’ (Riley et al. 2007)

For this thesis, we have chosen to mainly do a documentary study as secondary data collection method and gain supplement information through telephone interview in addition as our primary data collection method.

We have gathered the main empirical data from a documentary research in articles, governments and electronic web pages. We have chosen to use documents which come from government websites, like the Ministry of Finance, the National Office of Auditing and CICPA, which are highly reliable and trustable. The journals and electronic websites provide us more information that is relevant to our problem. In

addition, in order to supplement information, we set interviews with accountants and companies we can contact. For example, we contacted Mr. Zhu Ning who worked for the PwC and Mr. Li Xiao Meng who worked for Chinese Software & Service (CS&S). These means we gathered data from independent body and these data are first-handed. Related Q&A is listed in appendix.

We actually planed to do more interviews with Chinese auditors and accountants, and we tried to contact some accounting firms in China. However, due to the time, location and circumstances limitations, we were not able to do so. All the data we use in our thesis are official statistics, which is provided by the website of CICPA. Every year, CICPA will issue reports refer to the order of the first one hundred accounting firms in China, including the Big Four. These statistical reports include the turnovers, number of CPA, number of staff, and rank within this industry and so on. Thus, we believe all the data we used is reliable. And in these reports, all the data used from previous year. Thus, in our paper, data used in 2008 are issued by report of Year 2009.

And most data we collected, no matter primary data or secondary data, are in Chinese. And they are translated into English by us.

### **Validity and Reliability**

We have chosen to gather primary data through interviews and gather secondary data which are mostly derived from reliable unbiased sources, like from governments and legislators. These will make our thesis valid and reliable in context and for external readers. Our own interpretation and understanding were based on these fairly unbiased empirical data and findings.

### **Relevant**

In order to be relevant, besides gathering data from government websites, we also collected secondary data from journals, newspapers and electronic web pages, which

will make our information relevant to our problem statement. Moreover, we made several interviews as our first-hand information, concerning our topics.

#### ***III.4 METHODOLOGICAL LIMITATIONS***

We actually planned to do more interviews with Chinese auditors, accountants and government officers. However, due to the time, location and circumstances limitations, we were not able to do so. And also, we tried to contact some accounting firms in China to get primary data for our thesis. But, we did not get any response, because in China, it is now very hard to get information from companies since the information we need, like market share and client list etc., belong to their trade secret.

And the interview we made must be more or less subjective, but since the two interviewees are no longer auditors, so that we diminish the danger of being too subjective.

In order to diminish the limitations of first-hand data collection method, we supplemented these limitations by using sufficient secondary data.

## **IV. PEST Analysis: the macro-environment of Chinese local accounting firm**

### ***IV.1 POLITICAL (AND LEGAL) FORCES***

#### **IV.1.1. Analysis the political environment**

China is still a centralized country currently mainly because of the hierarchy cultural backgrounds and the roles of the communist party. Chinese communist party has representative in all state controlled companies and institutions. In the CICPA, besides the chairman, there is the vice secretary of communist party, Mr. Liang Li Qun, in the board of administration. This is Chinese character in accounting and auditing institution. It reflects the political influence in CICPA, which is impossible to exist in the AICPA.

#### **National strategy**

On 28<sup>th</sup> August 2007, China's central government organized conference to research world financial development and China's financial reform in the future. China's government has realized that the Big Four accounting firms have controlled 85% of auditing and accounting market for listed companies in China. Chinese domestic accounting firms only took account 6.2% of the market. More financial information has been grasped by foreign accounting firms. For foreign financial institutions, there have no commercial confidentialities of China's listed companies including some semi-state controlled ones such as the China Life Ltd. (China Accountants, 2009).

In capital market whatever in domestic and international one, Chinese companies are still lack of professional experiences in accounting and auditing standards. Immoderate relying on the services and analysis by international accounting firms means threat to the interests of Chinese companies because foreign accounting firms



(the Big Four in this thesis) have the possibilities to be part of rules makers in accounting and auditing in China. In that way, all business information could be controlled by the Big Four including core business information which should not be gained by any financial service institution. By getting the information, Big Four can monopoly the whole auditing and financial consulting markets. For example, Deloitte as project consultant had participated in the setting of China's accounting standards in Ministry of Finance since 1993, and assisted in the implementation of China's accounting standards in long term. PwC set the road map of corporation governing and management of financial risk control for the Industry and Commercial Bank of China in the plan of development. The Chinese partner of Ernst & Young was the member in Issuance Review Committee of China Securities Regulatory Commission (CSRC). Since 1995, the Chinese partner of KPMG worked as foreign professional advisor for setting Chinese Auditing Standards. (Yong, 2008, P10- 12).

Because of the cooperation with departments of Chinese government, there is little oversight of the Big Four firms operating in the Chinese market. The issuance and operation of Chinese listed companies including financial institutions are set under a status that there are not business secrets for the Big Four totally. As a result, we can see that in recent years China failed in series of investments overseas from Bear Stearns Cos to Black Stone. Through 20 years, local accounting firms have learnt experiences and trained qualified professional accountants. On the other side, Big Four firms have been involved in scandals of listed companies such as the issue of Jin Zhou Port by KPMG in 2001, China Aviation Oil by Ernst & Young in 2004, Kelon by Deloitte in 2005 and Huang Shan Travel by PwC in 2005. Big Four firms have been proved not to be able to keep auditing independent in Chinese market, which originally was introduced into China as guarantee for objective financial information. Big Four's reputations in China have been criticized. Big Four firms also have to consider their interests and clients' requirements. For all of these reasons, Chinese local accounting firms have been approved to audit A-share listed companies from last

year. (Yong, 2008, P5- 8)

#### **IV.1.2. Analysis the legal environment of Chinese CPA**

The following laws should be concerned about Chinese CPA: Accounting Law, Auditing Law, Law of CPA and the Administrative License Law. Related bodies are the National People's Congress (NPC), Ministry of Finance (MOF), National Audit Office (NAO), China Securities Regulatory Commission (CSRC) and CICPA. The NPC is Chinese legislation institution and the highest power institution in China. The MOF and NAO implement Accounting Law and Auditing Law respectively including setting accounting and auditing rules. The CICPA implements the Law of CPA which regulates the qualification of CPA, standards, responsibilities of CPA and CICPA and so on. Administrative License Law was issued in 2003 and came into effect in 2004. The purpose of the law is to simplify the complicated administrative procedures and decrease the chance of corruption. The law is adapted to all administrative procedures including regulation on CPA.

As for the oversight according to the mentioned laws, CICPA is supervised by the MOF (Ministry of Finance). Originally in 1980s, Accounting Consulting Department (former body of CICPA) was under the MOF. The NAO (National Auditing Office) and MOF take charge of the auditing of state controlled enterprise. The CSRC (China Securities Regulatory Commission) together with MOF takes charge of the auditing of listed companies in Chinese stock exchanges. We can find that there is overlapping in implementation and supervision among different departments and institutions. And, the CICPA has its own CICPA Constitution which indicates that both Ministry of Finance MOF and NAO supervise CICPA. This collides with the Law of CPA.

### ***IV.2 ECONOMIC FORCES***

#### **IV.2.1. The development of economy and service industry**

From 1978, Chinese economy has been transferred from high central planned economy to market economy with Chinese characters step by step. After 1990s, stock markets were introduced from the west countries. Even though the operations of economy have been the model of market economy, all policies are still set by the central government. This is the reason that the EU has not approved that China has been market economy. (CICPA, No. 2005-10, P13)

According to the figures from the National Bureau of Statistics of China, China's GDP was 30,067 billion Yuan (around 3000 billion Pounds) in 2008, which increased by 9% than 2007. Chinese service business only took up 40% in GDP, which is lower than other developing countries such as 64% of Brazil and 55% of India. In the United States, service business accounts for 77% in GDP. By researching the economic development of the United States in history, China has realized that only the increase of service business can promote the whole increase of national economy and create more employments. In March 2008, Chinese Central Government announced to establish a 'leading group' consisting of national senior officials. The aim of the group is to accelerate the development of service business to decrease the dependent on industry. Currently Chinese government only chooses officials from government to make final decisions in the development of service business but not the roles of market. (CICPA, No. 2008-6, P2-3)

According to the statistics of CICPA, by 2005, around 175 million Chinese people had endowment insurance and 180 million had Medicare insurance. This means a big potential insurance market in China because there are around 1.4 billion people in this country. Another example is that the circulation of credit cards in China was 1.2 billion in 2007, almost one card per person in average. In Japan, the average level was that 6.6 credit cards per person. And in China, only 55 million bank cards were real credit cards. The others are debit cards only. Potential huge markets of financial business provide more opportunities for new increases of Chinese economy. However,

the most pressing problem is that China lacks of qualified financial professionals at present such as qualified CPA. Most of the financial business has to be cooperated with foreign professional institutions to set regulations and plans. This problem becomes even urgent in current financial crisis which means new changes in consequence and system of international finance. (CICPA, No. 2008-6, P4 -5)

#### **IV.2.2. The scope of Chinese CPA profession**

According to the reports of The Exam System of CPA in China from the CICPA, the CPA exam system was established in 1991 in China. By 2008, the CPA exam has been held for 17 times in China. More than 3 million applicants took the exam and 140,000 passed required tests. The exam includes five tests total. Each applicant can not become CPA until the five tests get passed eventually. By the end of 2008, qualified CPAs with approved certificates have been over 50,000 in China. (CICPA, 2008)

Besides the CPA exam, from 1997 to 2002, the CICPA organized a special exam every year to select qualified CPAs for the auditing in stock and futures market in China. Around 3000 CPAs got the qualification and have become the main resources of auditing in stock and futures market. Also from 2005, a professional test has been organized yearly by the CICPA to choose senior talents from Chinese accounting firms. Around 150 senior CPAs have been chosen for auditing of Chinese companies in international capital market. With the economic development in China, qualified CPAs are not enough especially the CPAs who are familiar with international accounting and auditing standards. The Ministry of Finance has announced that China needs at least 300,000 qualified CPAs at present. And this number will increase in the future. (CICPA, 2008)

In auditing market, according to the Top 100 Accounting Firms Report 2008 published by the CICPA on the 30<sup>th</sup> April 2009, the revenue of the 100 accounting

firms are 19.66 billion Yuan (around 1.97 billion Pounds) in 2008, which increased by 19.55% than 2007. However, because of the influences of global financial crisis, this increasing rate is lower than that of 39% in 2007. The structure of market share is not changed in general. The Big Four firms are still the biggest in China and their revenues are 10.4 billion Yuan (around 1.04 billion Pounds) and take up 52.83% of the market. There are more sales from consulting services by the Big Four accounting firms. Figures about auditing service (except Year 2008) have not found so far from authoritative institutions such as the CICPA and NAO. (CICPA 2008, CICPA 2007)

### ***IV.3 SOCIOCULTURAL FORCES***

#### **IV.3.1. The general public's recognition degree of CPA**

As mentioned above, there have been over 3 million applicants taking the CPA exam so far. During the course of 2007 and 2008, alone, there were almost 600,000 each year sitting the exam. In relation to the population of China, 3 million is a small percentage of the population. This upswing in popularity of the CPA exam is largely due to the increase in the Chinese Economy and the subsequent demand for accounting and auditing professionals to serve the Financial and Service sectors expansion. The Government is also anxious to realize more qualified accountants to safeguard national interests and actively encourages the creation of this vast army of accountants. The CPA exam is one of the most stringent professional exams in China which includes accounting, auditing, management cost control, accounting law and tax law. The pass rate for the exam (single course) has been only around 10% every year. The general pass rate of all courses is even lower. The CPA certificate means a stable and relatively high salary. These factors are the basic reasons that millions of people take the exam currently in China. (The passing rate of the CPA Exam, 2007)

#### **IV.3.2. The influence of the level of social ethics to CPA**

According to the opinions of Professor Zhang Wei Ying from the Peking University, current Chinese society lacks trust in commercial environment because of the following reasons:

Firstly, original concepts of good faith in history and culture were destroyed badly in late 19<sup>th</sup> century when the Qing Dynasty declined. Chinese original concepts were totally negative by social intellectuals because they had not been advanced to make China strong. More intellectuals went to Europe and Japan to look for advanced theories and concepts. After Chinese communist came into power in 1949, old culture and concepts were in great calamity during the Great Revolution of Culture. All the old things had to be eliminated in ideological and physical existences. The restriction of social faith was demolished. Even now, people will not feel guilty because of crimes but to look for ways to avoid punishment.

Secondly, ‘political power leads to corruption. Absolute political power leads to absolute corruption’. In Chinese society, there are no effective restrictions to the government. Privileged group from the government control more social resources and policies including accounting and auditing. Government behaviors dominate the whole society. Issued financial policies and regulations could be interfered by government’s decisions. Social good faith declines even further.

Lastly, the property rights are uncertain. The Law of Property of PRC was issued and came into effect on 1<sup>st</sup> October 2007. Legally private properties can not be infringed but there are still behaviors the law, which can not be protected by government. One typical policy is that Chinese people have rights in owning house or plant but not the land of house or plant. Citizen only has rights to use the land for 70 years. It is impossible to establish social good faith until the permanent property right and trust are guaranteed in Chinese cultural backgrounds.

The situation in Chinese society mentioned above has left negative influences in all aspects in the society. The influences in auditing and CPA are especially typical. For example, every accounting firm in China emphasizes and assures that the independence and ethics of CPA are guaranteed. But the public still believe that any accounting firm and any CPA has to consider the opinions and ‘traditional ways of thinking’ of clients in auditing because of profits and market share.

#### ***IV.4 TECHNOLOGICAL FORCES***

##### **IV.4.1. Higher requirement of auditor’s profession**

Before the CICPA was founded in 1988, there had been around 200 accounting firms and 2000 CPA in China. During that period, accounting firms and CPA were approved by the CPA Statute issued by the State Department of PRC. These accounting firms and CPA played important roles in introducing foreign investment and promoting Chinese economic reform after the Revolution of Culture. However, with the progress of Chinese market economy, problems in accounting and auditing businesses emerged that professionals and markets lacked of standardization. (CICPA, No. 2005-10, P11-13)

In the beginning of 1990s, the Big5 entered in Chinese market. In 2001, when the issue of Enron happened in the US, there also taken place the scandals of auditing and accounting frauds in listed companies in China such as the Yin Guang Xia and Lan Tian Ltd, which led to the loss of reputation of Chinese local auditing firms. To resolve these problems to keep the accountability in stock market, the CSRC decided to use the system of Big Four. In the following years, local Chinese local firms declined sharply in auditing market. This is the expense for the whole accounting and auditing business in China. On the other side, local firms and official institutions learnt standard concepts, standards and experiences in international context. All of these will and have accelerated Chinese reform in accounting and auditing system.

(The analysis in the Tax Avoidance of the KPMG, 2008 & The Big 4 controls the business of auditing and accounting in China, 2007)

Currently, to guarantee the quality of auditors' profession, there are CPA Law of PRC, Ethic Guidance for Chinese CPA, Basic Standards for CPA Business Identification and Auditing Standards of CPA. The CPA Law of PRC was issued by the National People's Congress (NPC) and came into effect in 1994, which is the foundation of the other regulations. Ethic Guidance for Chinese CPA was issued by the CICPA in 2002. The aim of the Ethic Guidance is to enhance CPAs' trustworthy, standardize CPAs' ethical professions, maintain CPAs' reputation and protect public interests. Basic Standards for CPA Business Identification and Auditing Standards of CPA were issued by the CICPA under supervision of the Ministry of Finance (MOF) and implemented in 2007. Original Independent Auditing Standards were abolished. The Basic Standards for CPA Business Identification including 22 terms set auditing aims, elements, scales and standards used in audit. Auditing Standards of CPA including 26 terms describe detail audit processes such as Auditing Principles of Financial Statements, Audit Evidence, Audit of Disclosure and Measurement of Fair Value and so on. The abolished Independent Auditing Standards is replaced by further detailed and professional standards.

#### **IV.4.2. Wider use of computer auditing**

According to the requirement (No. 161, 2008) of the Ministry of Finance, all the financial reports from state-controlled enterprises and financial departments of local governments should be submitted in both printed and electrical version. Actually from the beginning of 2000, computers had been widely used in accounting and auditing by all large companies in China. When we worked in China, we realized that even very small sized accounting firms and companies had prepared financial reports by the help of computers.



The cheap price of digital products and super function of calculation make it possible for all companies to accept the comprehensive use in transacting financial statements of computer. Computer technology does bring convenience in calculation in accounting and auditing. It has become conventional to use computer in accounting and auditing sphere in China so far. Normally financial reports are required to be saved and submitted in both printed and electrical versions. As for the software, almost all companies choose the Excel and Windows of the Microsoft series.

Besides the financial reports, professional software has been widely used in the process of transacting accounting and auditing. There are special auditing software such as ZP and ERP (Enterprise Resource Planning) software including the function of auditing. Software manufacturers from abroad such as SAP (Systems Applications and Products) and SSA Global compete with Chinese local software companies such as the UFIDA and Kingdee. Among these companies, the UFIDA is listed company in Shanghai Exchanges (Stock Code 600588) and the biggest ERP provider in China. (UFIDA Annual Report 2008)

The UFIDA had market share of 21.3% followed by Kingdee (10%) and SAP (9.9%) in 2008 (UFIDA Annual Report 2008, P4). The UFIDA has more customers because the local company designs software about accounting and auditing based on Chinese Auditing Law and Accounting Law. Foreign companies design the software mostly in terms of international accounting standards or that in original countries. Foreign companies set framework of software for international market but Chinese local ones only lock Chinese market mostly. Also local software companies know about Chinese habits in using software much more in that these functions are easily accepted by Chinese companies. And local Chinese software companies have lower price than foreign ones. (UFIDA Annual Report 2008, P11)

Even though Chinese software companies have more advantages than foreign rivals,

the core technologies still are controlled by foreign companies. The interface and function are totally in Chinese and based on Chinese law but the database system and client terminal system are usually Oracle and Windows which are designed by American companies. When we contacted Chinese Software and Service (CS&S), we found that even the tools software used in designing ERP are from foreign companies such as Power Builder and tools based on web technologies. From a strategic point of view, China needs to develop own database and operating system in our opinion, which accord with Chinese national strategy in financial system.

#### ***IV.5 CONCLUSION***

It is very necessary to have the research of PEST in this thesis because China has very different macro environment of economic development including accounting and auditing systems from western society. Through the analysis of PEST, we have gotten a general comprehension in macro environment in Chinese economy currently including political and legal forces, economic forces, social cultural influences and technological forces. The discussion of PEST analysis is the foundation for further analysis in the setting and policies of Chinese auditing, and the case research in the paper.

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## **V. Porter's five forces model: Analysis the industry environment and competitive structure of Chinese local accounting firm**

As mentioned above, the CPA profession is straight space for the developing of accounting and accounting firms, and also, is those firms' external environment which directly impacts their operating activities. From the world's or developed countries' point of view, the CPA profession has been progressing for hundreds of years, and now it is already mature, which is demonstrated by several waves of merge and acquisition among large firms who put great emphasis on competitions of service and cost.

The CPA profession of China has the characteristic of dispersivity, which means most firms within this industry are Small and Medium-Sized Enterprises (SMEs), there is no scale economy, and none of those firms could affect the operation of this industry. This characteristic has got its own objective reasons. Reckoned from recovery of Certificated Public Accountant (CPA) in China in 1980, it has been only less than 30 years for accounting and accounting firms to establish and progress, which illustrates the CPA profession in China, is still at the initial stage. Before "Reform of CPA Firm Management"<sup>1</sup> in 1999, while functional departments of government create kinds of requirement of professional service supplied by CPA, they separately set up their own subordinate accounting firms. It was so easy to set up new accounting and accounting firms that we could know the barrier to enter into this industry was extremely low. Meanwhile, various kinds of job qualification certificate had become different barriers among different professional service within this same industry, because those firms were protected by different departments. Those reasons above have divided the

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<sup>1</sup> It was one system change of accounting and accounting firm in China in 1999, which goal was to set up new management system so as to accommodate socialist market economy. It would form operation mechanism that keeping the accountant being dominant object of investment and responsible for legal obligation independently, and make those firms to become independent management at their own risk.

market of CPA, and directly led to current situation of the market, which are narrowness, dispersedness and chaos. However, because of intense competition, most SMEs lack of bargaining power, so that there are vicious price competition within this industry. In order to change this dispersed structure and seek for sustained, stable and coordinated development, this industry needs restructure, e.g. merge and acquisition should be one of considerable strategies.

Michael Eugene Porter, who is a leading authority on competitive strategy and international competitiveness, believes that there are five basic competitive forces within one industry, which are potential entrance (threat of new market entrants), substitutes (threat of substitute products or service), buyers (bargaining power of buyers), suppliers/cooperators (bargaining power of suppliers), industry competitors (rivalry among existing firms). These five forces determine the competitive intensity and therefore the earning capacity. And Porter referred to these forces as the micro environment, to contrast it with the more general term macro environment which we have discussed above. Now, we shall use this theory to analysis the micro environment of Chinese local accounting and accounting firms. (Wang and Hou 2009)

### ***V.1 POTENTIAL ENTRANCE (THREAT OF NEW MARKET ENTRANTS)***

Whether potential competitors can actually come into and become a hazard of one industry depends on the entrance barrier this industry got. We consider there are four main factors that constitute the entrance barrier of CPA profession. Following Porter's framework, we have developed our analysis.

#### **V.1.1. Economies of scale**

When there are economies of scale, unit cost of accounting and accounting firm will decrease, because the firm increases its absolute quantity of service within one period. These will form barrier to enter, which will force new entrance to enter into the CPA

profession on a large scale. Or if new entrances still want to enter into this industry without a large scale, they have to take the high cost risk and must be resisted by existing firms strongly. Unfortunately, Chinese local CPA profession still has not built up such a scale economy that could not withstand the entrance of foreign accounting and accounting firms. On the contrary, the result of competition is that Chinese local firms will undergo atrophy, or become member firms of foreign big firms, or even disappear. (Liao 2008)

### **V.1.2. Product differences**

The reason that product differences exist, is chiefly because customers have got different level of loyalty to the quality of service and reputation provided by one specific accounting and accounting firm. Once there are barriers of product/service, new comers will absolutely need more time to fight. But, we shall see the fact, which is, neither quality nor reputation of Chinese local accounting and accounting firms is better than foreign firms. (Liao 2008)

### **V.1.3. Resources superiority**

Existing accounting and accounting firms can set barriers by their own advantages on human resource or technology. And it was apparent to all that, Chinese local accounting and accounting firms urgently need to draw lessons from foreign firms both on business ethics and professional performance. (Liao 2008)

### **V.1.4. Government policy**

Although the threshold for accounting firms is sufficient high, the audit market of china is being expected by numerous international accounting firms besides the Big Four. After China entered the World Trade Organization (WTO), those limitations for

foreign accounting and auditing firms on scale of business, quantity of mechanism and foreign staffs etc. would have been cancelled. And finally, China will eliminate all obstacles for free trade of accounting and auditing service that are recognized by the WTO. Hence, as potential entrants, those foreign companies with long history and good reputation will strike Chinese accounting and auditing markets and compete directly for market share, using their rich experience in marketing competition, advanced professional technology and strong international background. (Liao 2008)

### ***V.2 SUBSTITUTES (THREAT OF SUBSTITUTE PRODUCTS OR SERVICE)***

Substitutes are those services which have same or similar functions. Under the circumstance of equal quality, the price of substitutes will be more competitive. The services provided by accounting and auditing firms include auditing service, taxation service, management consulting, legal advice, assets evaluation and so on. Among all the services provided by accounting firms, only audit work can not be substituted. However, other services, especially consulting services, can be replaced by accounting firms, consulting firms, law office, or evaluation sectors, because this kind of service depends on varies kinds of knowledge and information which can be collected through internet rapidly. While tax declaration software has been come into being, the market of tax agency is shrinking instead of growing. (Liao 2008)

### ***V.3 BUYERS (BARGAINING POWER OF BUYERS)***

When accounting and auditing firms choose their buyers/customers, we believe they should know their customers first, and try to find their buyers who can seldom influence them in order to minimize the bargaining power of buyers. Currently, buyers are very capable on competition in the accounting and auditing service market as a whole. Those services buyers got are normal and even no differences. In this case, buyers can choose suppliers, and stimulate suppliers' competition with each other, and they do not need to buy service from any specific firms. However, some corporations who want to be listed, always have less bargaining power, because there are rules

published by Stock Supervisory Committee regulate that listed companies should publish their annual report which has been audit by qualified accounting firms, always the Big Four firms. And if listed company wants to change accounting firms, they have to disclose it as important items. That is why listed companies do not feel like changing accounting firms easily. (Liao 2008)

#### ***V.4 SUPPLIERS/COOPERATORS (BARGAINING POWER OF SUPPLIERS)***

As is known to everyone, the accounting and auditing industry belongs to knowledge-intensive industry, within which, the main resource is human. Therefore, CPAs are main suppliers in this industry, and they actually have got upper bargaining power. In china, the examination of CPA is the hardest professional test, and the percent of pass is only around 10%. Thus, qualified CPA becomes the most valuable certificate. According to the statistics done by China Ministry of Finance, the talent shortage in china is no less than 300 million. Besides that, accounting and accounting firms are not the only objects that CPAs can work for. Most of companies pay the utmost attention to CPA when they consider hiring people in financial department. For these reasons, CPA has got bargaining powers. (Liao 2008)

#### ***V.5 INDUSTRY COMPETITORS (RIVALRY AMONG EXISTING FIRMS)***

The main competitors in Chinese audit market are the Big Four firms and Chinese big local accounting firms. We will compare these two groups of accounting firms in the following contents. (Liao 2008)

#### ***V.6 CONCLUSION***

This chapter analysis micro environments of CPA profession and audit market in China from five areas, which are threat of new market entrants, threat of substitute products or service, bargaining power of buyers, bargaining power of suppliers and Rivalry among existing firms. By looking deeply into this industry, we could do

furthermore analysis with the following case study.



## VI. Case study

### VI.1 CASE RESEARCH

Every year, the CICPA publishes the Top 100 Accounting Firms in China including main business performance figures such as sales, CPAs and so on. To compare the changes of sales and market shares between Big Four and local Chinese firms, we choose series of numbers based on Top 100 accounting firms from 2006 to 2008 to set following charts:

Exchange rate: Pound/Yuan=10.3

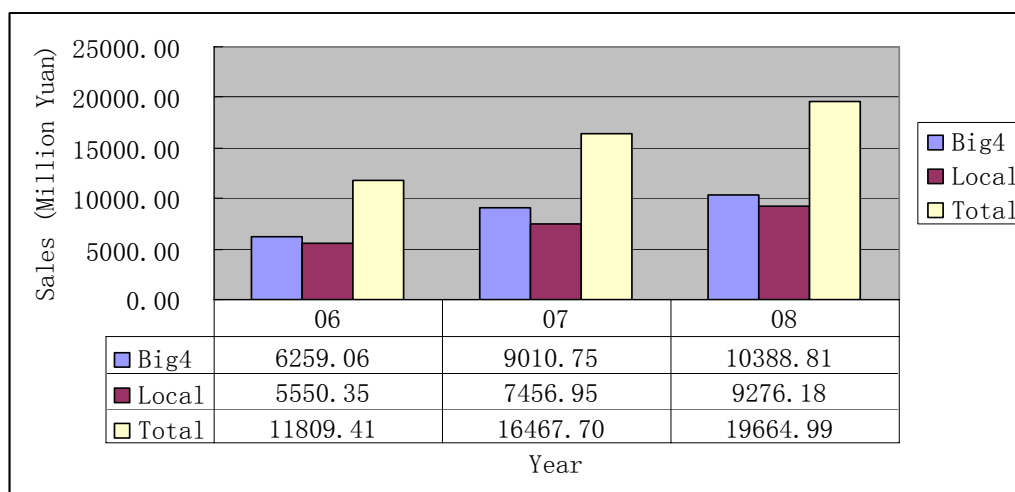


Figure 2 Sales of Big Four and local 96 Chinese accounting firms from 2006 to 2008

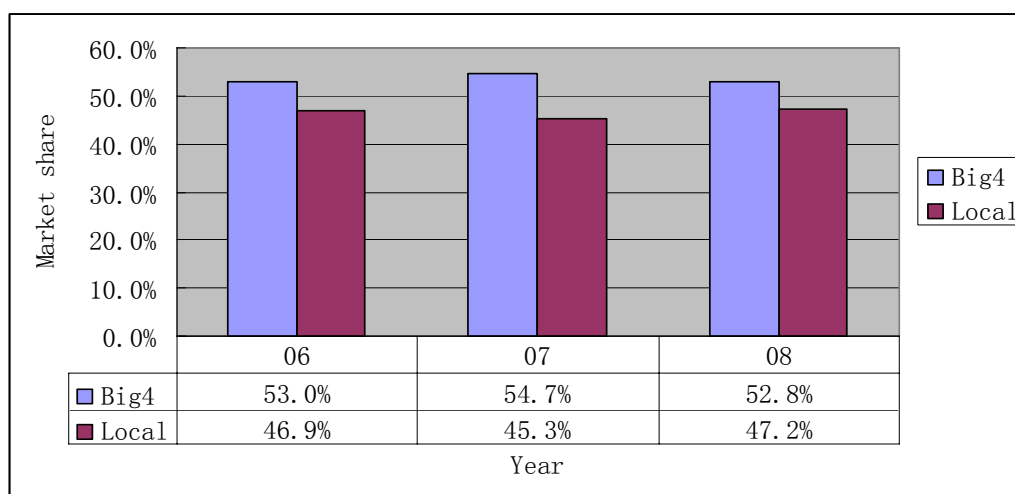


Figure 3 Market Share of Big Four and local 96 Chinese accounting firms from 2006 to 2008

From the two charts, we can see that the whole auditing market in China has increased from 11809 million Yuan in 2006 to 19664 million Yuan in 2008. The sales of Big Four and local 96 Chinese firms also rise steadily. In the contrast of market share, changes are slightly. In China, there are several reasons that one company should change accounting firms. They are: (1) according to the requirement of State-owned Assets Supervision and Administration Commission of the State Council (SASAC), accounting firm is enforced to change when it has provided audit service for 5 years; (2) long distance or schedule which is inconvenient of communication; (3) restructure of company or change of Substantial Shareholder; (4) acquisition or merger between accounting firms. Although there are hundreds of listed companies that change their accounting firms, those who change their accounting firms from the Big Four to Chinese local firms and from Chinese local firms to the Big Four are pretty even (see Table 6 and 7). Thus, this should be the main reason for the slightly changed market share. And we think that current structure of the market share will last for several years. Local firms still can not compete with the Big Four whatever in auditing scales and skills currently.

Table 6 Changes from domestic accounting firms to Big Four

<b>Local Chinese accounting firms → The Big Four</b>			
<b>Code in exchanges</b>	<b>Abbreviation of listed company</b>	<b>Current Accounting Firm</b>	<b>Previous-accounting Firm</b>
<b>Year 2006</b>			
000932	HUA LING	KPMG	HUNAN KAIYUAN
600801	HUAXIN Cement	PwC	XINYONG
600104	Shanghai Auto	Deloitte	YONG AN
600707	Rainbow Ltd	PwC	BEIJING WULIAN
600115	Orient Airline	PwC	SHANGHAI HUYIN
<b>Year 2007</b>			
000001	SHEN Development	Ernst & Young	SHENZHEN PENGCHENG
600030	ZHONGXIN Securities	Ernst & Young	TIANHUA ZHONGXIN
000659	ZHUHAI ZHONGFU	KPMG	HENGXIN DELU

000935	CHUAN SHUANGMA	Deloitte	JUN HE
600221	HAINAN Airline	PwC	XINYONG ZHONGHE
600508	Shanghai energy	PwC	ZHONGRUI YUEHUA
<b>Year 2008</b>			
600299	LANXING	PwC	XINYONG ZHONGHE
000598	LANXING Cleaning	PwC	TIANZHI International
600415	XIAOSHANGPIN	Ernst & Young	ZHEJIANG TIANJIAN
600528	CHINA Rail Corp	Deloitte	BEIJING JINGDU
000999	SANJIU Pharmacy	Ernst & Young	ZHONGRUI YUEHUA
000698	SHENYANG Petrochemical	PwC	XINYONG ZHONGHE

Figures published by the CICPA

Table 7 Changes from Big Four accounting firms to domestic ones

<b>The Big Four → Local Chinese accounting firms</b>			
Code in exchanges	Abbreviation of listed company	Current Accounting Firm	previous-accounting Firm
<b>Year 2006</b>			
000520	G CHANGHANG	YUE HUA	KPMG
600718	DONG Software	LIAONING TIANJIAN	PwC
600406	GUO DIAN NANDUAN	JIANGSU TIANHENG	Deloitte
000018	SHEN ZHONGGUA (A、B)	XINYONG ZHONGHE	PwC
000585	DONGBEI Electric	SHENZHEN PENGCHENG	Deloitte
001896	YU Energy	HUAHENGXIN	Deloitte
000413	BAOSHI A	ZHONGXI	PwC
600537	HAITONG Corp.	SHULUN PAN	PwC
600726	HUADIAN Energy	DA XIN	Ernst & Young
200512	MIN CAN KUN B	LI AN DA	Deloitte
<b>Year 2007</b>			
000100	TCL Corp.	DA HUA TIANCHENG	Ernst & Young
600860	BEIREN	XINYONG ZHONGHE	Deloitte

600707	HAIHONG	XINYONG ZHONGHE	PwC
601002	PUYI	ZHEJIANG TIANJIAN	PwC
<b>Year 2008</b>			
600009	Shanghai Airport	SHULUN PAN	PwC
000096	GUANGJU Energy	LI AN DA	PwC
600188	YUNZHOU Coal	XINYONG ZHONGHE	Deloitte
600567	SHANYING PAPER	LI AN DA	Deloitte
000898	AN STEEL	ZHONGRUI YUEHUA	KPMG
600329	ST ZHONGXIN	ZHONGRUI YUEHUA	PwC
200053	SHEN JI DI B	ZHONGRUI YUEHUA	PwC
600751	ST TIANHAI	ZHONGHE ZHENGXIN	PwC
200053	SHEN JI DI B	ZHONGRUI YUEHUA	PwC

Figures published by the CICPA

The whole market of auditing will still increase in the future, which brings opportunities of growth for both Big Four and local firms. The policies from Chinese government supporting local firms will be the important factors to change the structure. It is the policy of introducing foreign accounting firms and related concepts by CSRC in 2001 that causes the sharp growth of the Big Four in Chinese auditing and accounting market. During the past 8 years, local firms have got lessons and advanced skills and concepts in accounting and auditing by competing with the Big Four. China encourages building strong local accounting firms from aspects of both national financial strategies and auditing business. When local firms become strong enough to take financial and social accountabilities, related policies in favor of local firms will become reality.

As for the Big Four accounting firms, the same scandals as local firms have been exposure in these years. The effects of checking and oversight by the Big Four have been criticized by the public. Under the influences of Chinese culture and market

profits, it is difficult for the Big Four to insist in pure objectivity and independence of auditing. However, the quality and reputation in auditing are Big Four's distinct advantages in market, which are guaranteed by objectivity and independence. New increase for the Big Four in China is how to keep the balance: compromise in quality because of market profits or insisting in quality because of market fame.

Besides the sales, we compare the working staffs of the Big Four and local Chinese firms.

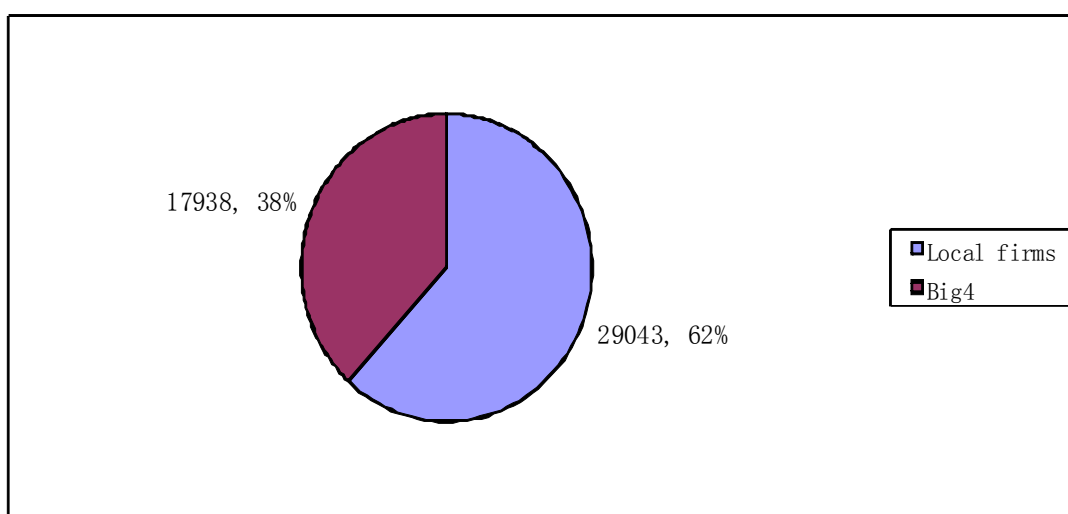


Figure 4 Working staffs of local Chinese accounting firms and Big Four in 2008

The Big Four has fewer staff than local Chinese firms in general but higher revenues. This shows that the Big Four's management and professional system are better than Chinese firms. From the following table, we can see that each Big Four firm has more staff than each single Chinese firm. For example, the PwC has 4583 staff. Among Chinese firms, the biggest ZHONGRUI YUEHUA has only 1825 (after merger) in contrast. As for auditing clients, the Big Four control more large sized listed companies in China such as large banks and manufacturers. Local Chinese firms mostly have middle and small sized companies (listed and individual). Large companies choose Big Four not only because of reputation but also the strong and effective capabilities of transacting auditing in large scale. It is impossible for most of local Chinese firms with several hundred of staffs to deal with auditing for large sized

companies. It is a challenge for local Chinese firms to increase professional capabilities and qualified staffs at the same time without compromising team and professional qualities.

### **Policies by the Chinese government in support of domestic accounting firms**

Because of the political nature of China's administration of the economy, it is not always the simplest of tasks to find published reports officially released into the public domain. These supporting policies by government may well only surface as partial directives from the numerous ministries that are involved in policy making. Although we have repeatedly heard reference to the Governments policies in support of the domestic accounting firms, in reality we found it difficult to actually find it mentioned in it's entirety as an officially released Policy. However, it is mentioned in several reports from the CICPA that we read. On CICPA official website news and reports introducing policies from the government. Two of the articles were about Policies which are in support of domestic accounting firms. One is a brief introduction by the chairman of the CICPA Mr. Liu Zhong LI about the proposed support of domestic accounting firms in market expansion and export of accounting services, which was published on the 26<sup>th</sup> December 2007. These were issued by several ministries including the Ministry of Finance and the Ministry of commerce. The second article is called 'Venture out of China': looking for an ally which refers to the cooperation between ZHONGRUI YUEHUA with RSM and SHULUN PAN with BDO. These cooperations will be analyzed more closely at a later stage. (CICPA, 2008)

### **Research of domestic Chinese accounting firms**

Besides the contrast between the Big Four and local Chinese firms, we also analyze the situation among local ones. From the Top 100 firms 2008, we chose the 32 firms whose revenue is more than 100 million Yuan and they are listed as followings:

Table 8 Accounting firms whose sales are over 100 million Yuan in China 2008  
2008 Currency: Yuan Million

	Name of Accounting Firm	General Revenue	Sales of Audit	Staffs	CPAs
1	PwC	2755.18	2609.84	4583	587
2	E&Y	2700.00	2262.51	4094	750
3	Deloitte	2498.82	1704.49	4371	668
4	KPMG	2434.81	1540.17	4890	550
5	SHULUN PAN	<b>666.39</b>	<b>518.17</b>	1315	<b>679</b>
6	ZHONGRUI YUEHUA	<b>652.17</b>	<b>554.33</b>	1825	<b>1013</b>
7	WANLONG Asian	398.39	300.11	1183	556
8	PAN-China	314.66	244.01	930	339
9	DAXIN CPA	313.73	275.50	946	360
10	SHINEWING CPA	261.53	222.87	803	590
11	LI AN DA	272.53	246.77	950	532
12	TIAN JIAN GUANG HUA	239.44	214.40	903	402
13	TIAN ZHI International	242.58	208.58	654	332
14	BEIJING JING DU	260.47	236.39	706	351
15	ZHONG HE ZHENG XIN	196.75	149.37	651	430
16	ZHONG SHEN	210.88	183.38	546	397
17	BEIJING XINGHUA	134.76	118.65	353	255
18	ZHONGZHUN	119.67	113.81	660	326
19	ZHONGHUA HUYIN	144.05	131.36	209	111
20	ZHONG LEI	130.12	110.80	446	319
21	GUANGDONG DAHUADE	122.64	109.69	376	202
22	GONGZHENG TIANYE	126.76	113.12	193	132
23	ZHONG SHEN International	120.22	106.02	253	185
24	ZHONG HUI	115.31	63.93	353	152
25	HUAPU TIANJIAN	104.88	93.09	304	219
26	KAI YUAN XIN DE	119.11	99.26	374	234
27	SUYA JINCHENG	113.27	88.57	252	152
28	WANG BANG	117.51	96.50	275	146
29	ZHONG TIAN YUN	101.65	88.25	322	225
30	ZHONGQIN WANXIN	116.66	79.13	300	258
31	PENG CHENG	100.21	97.05	255	130
32	TIAN HENG	106.48	88.13	301	157

Information published on the 30th April 2009 By the CICPA

Exchange rate: Pound/Yuan=10.3

We make the following pie chart to compare the 28 Chinese accounting firms from Table 7 with the other 68 Chinese firms in sales and working staff. These domestic

accounting firms are from the Top 100 accounting firms in China.

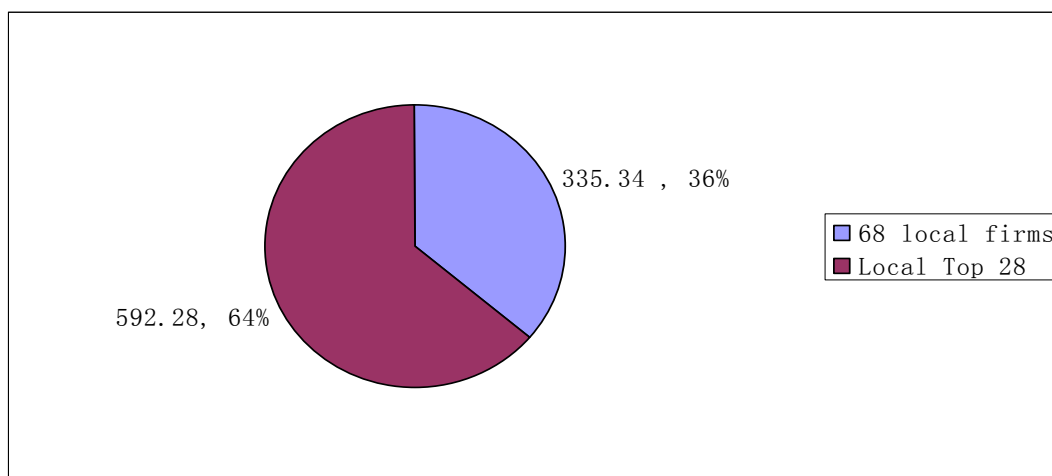


Figure 5 Sales of local Chinese accounting firms in 2008

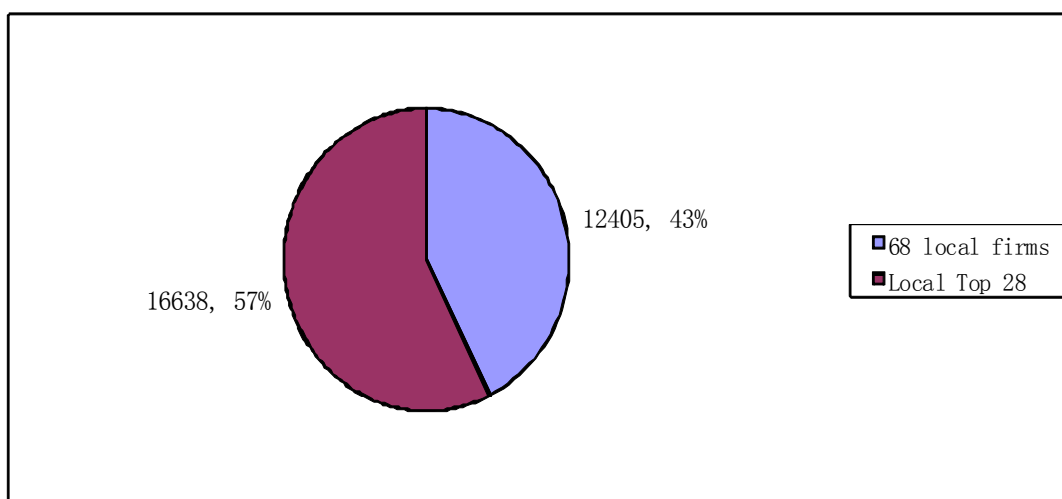


Figure 6 Working staffs of local Chinese accounting firms in 2008

From the two charts, it is clear that the 28 firms have advantages in both sales in market and working staffs. Chinese government could encourage the 28 accounting firms by supporting policies. Coordination could be implemented by government to avoid unnecessary competition which is harm to the growth of local accounting firms. Among these local accounting firms, there are two typical companies. The sales of the two firms take up 14.2% of sales by local firms. And working staffs from the two firms take up 10.8% of total local firms. The two accounting firms are ZHONGRUI



YUEHUA CPA Accounting Firm and SHULUN PAN CPA.

**ZHONGRUI YUEHUA CPA Accounting Firm (<http://www.chncpa.cc>)**

In December 2007, with the merger of the original China Rightson accounting firm and YUEHUA accounting firm, the fifth biggest accounting firm in China came into being. It is called the ZHONGRUI YUEHUA CPA Accounting Firm. And this is the second biggest firm in domestic Chinese accounting firms in 2008. After the merger, ZHONGRUI YUEHUA has 2600 partners and staffs. And the firm has the most CPAs in China. In terms of the official website of the firm, ZHONGRUI YUEHUA has 45 big state-owned corporations and 72 listed companies as auditing clients in China. In the report of the RSM Nelson Wheeler, the auditing clients of listed companies will be more than 100 in 2009.

In January 2008, the ZHONGRUI YUEHUA joined the RSM International, the seventh largest independent accounting and consulting network in the world, as a full member. This is encouraged by the Ministry of Finance under the policy of ‘ZouChuQu’ (to venture out of China). By the help and reputation of the RSM International, China wishes that ZHONGRUI YUEHUA could be competent to audit Chinese companies listed overseas in the future. And ZHONGRUI YUEHUA could be a model of development for all local Chinese accounting firms.

**The SHULUN PAN CPA Accounting Firm (<http://www.pcpa.com.cn>)**

SHULUN PAN CPA was founded in Shanghai in 1927 by PhD SHU LUN PAN. In 1986, SHULUN PAN CPA was re-established. Before 2001, SHULUN PAN CPA was the biggest accounting firm in China by holding the most market share. From 2002 to 2005, SHULUN PAN CPA was the fifth biggest following the Big Four in China. In August 2004, SHULUN PAN CPA got approval to register in the PCAOB in the US. In January 2009, SHULUN PAN CPA signed contract of cooperation with the BDO International which is the fifth biggest accounting firm in the world. According to the

report by the PCAOB, Registered Public Accounting Firms with the Public Company Accounting Oversight Board, 47 accounting firms from China including the Big Four accounting firms in China have been resisted in the PCAOB.

By 2008, SHULUN PAN CPA has 1315 staffs including 679 CPAs. SHULUN PAN CPA has more than 2000 auditing clients of foreign invest companies in China. So far, SHULUN PAN CPA has 150 auditing clients of listed companies (A share) in China.

ZHONGRUI YUEHUA and SHULUN PAN are in the leadership among local Chinese accounting firms. To get further development, both of them adopt to cooperate with the competitors of the Big Four in the world. This cooperation is not joint venture in business but communication of skills and experiences. The new models of cooperation will bring real increase for ZHONGRUI YUEHUA and SHULUN PAN.

Both ZHONGRUI YUEHUA and SHULUN PAN do not merge with RSM International and BDO. ZHONGRUI YUEHUA and SHULUN PAN are the network members of RSM and BDO respectively. And according to the purpose introduction of RSM, 'The RSM difference lies in the close and enduring relationships between our member firms, and is grounded on the quality and commitment of our people. RSM member firms share a common belief that it is through constantly striving for excellence and by working closely together that lasting success is generated.' In the report of 'The world of BDO', it indicates definitely that 'BDO is the brand name for the BDO International network, and all BDO Member Firms'. The RSM and BDO have not had direct business and subsidiaries in Chinese market so far.

### **Top 7 Accounting firms in the world**

On the 25th September 2008, the Wolters Kluwer (CCH) released the 'Public Accounting Report Finds Top 100 Firms Post Double-digit Growth for Three Years

Running'. According to the report, the Top 100 accounting firms kept average increasing rate at 16.5%. And the increasing rate of small and medium sized accounting firms had been 21.9% which exceeded the increasing rate of Big Four, 14.7%. We chose the 7 biggest accounting firms from the report to compare as following table:

Table 9 Top 7 accounting firms in the world 2008

Rank	Name of accounting firm	Revenues in 2008
1	Deloitte (New York, N.Y.)	27.4 billion US\$
2	PricewaterhouseCoopers (New York)	28.2 billion US\$
3	Ernst & Young (New York)	24.5 billion US\$
4	KPMG (New York)	22.7 billion US\$
5	RSM McGladrey (Minneapolis)	1.4 billion US\$ (combined sales)
6	BDO Seidman (Chicago)	5.145 million US\$
7	Grant Thornton (Chicago)	3.956 million US\$

From Table 9, total sales of RSM, BDO and Grant Thornton were much lower than any Big Four accounting firm. It means that the Big Four can not be challenged in international market. ZHONGRUI YUEHUA and SHULUN PAN cooperate with RSM and BDO respectively because the Big Four accountings firms have had own partners in China. Grant Thornton has two members in China, Grant Thornton Zhonghua and Grant Thornton China CPA Ltd, which also cooperates with Grant Thornton.

## ***VI.2 SWOT ANALYSIS***

We choose one typical local Chinese accounting firm, the ZHONGRUI YUEHUA CPA Accounting Firm, to make SWOT analysis because this firm is the biggest one among domestic accounting firms so far. And the ZHONGRUI YUEHUA is the first local Chinese firm that cooperates with foreign accounting firm to expend markets in

China and overseas in the future, which is encouraged by the Ministry of Finance.

Strengths	Weaknesses
<ul style="list-style-type: none"> <li>● The biggest local Chinese accounting firm with 2600 staffs including 1013 CPAs</li> <li>● Broad qualifications in accounting and auditing in China</li> <li>● The member of RSM International which is the seventh largest independent accounting and consulting network in the world</li> <li>● Supporting policies by the Ministry of Finance</li> <li>● Holding clients including 45 big state-owned corporations and 72 listed companies in China</li> <li>● Strong networks in China with 19 branches in Hong Kong and main cities in mainland</li> </ul>	<ul style="list-style-type: none"> <li>● Newly established by merger of two accounting firms in 2007</li> <li>● Managers in senior administration are still foreign partners from RSM</li> <li>● The quality of staffs is lower than the Big Four in China</li> <li>● Lack of experiences in the business of international market</li> </ul>
Opportunities	Threats
<ul style="list-style-type: none"> <li>● More clients in China including state owned and listed companies</li> <li>● By the cooperation of RSM, new clients and business in international market</li> <li>● Potential increase in economy in China</li> <li>● Open policies in financial business from the government</li> </ul>	<ul style="list-style-type: none"> <li>● Competitors from local Chinese firms such as the SHULUN PAN CPA</li> <li>● The Big Four</li> </ul>

### Conclusions of the SWOT analysis

#### S-O strategies

ZHONGRUI YUEHUA should enforce the cooperation with the RSM International to get international experiences in accounting and auditing. Also an effective training system should be built for staffs. The qualified staffs should be increased in short time to receive more clients. The lobbying should be enhanced by the help of CICPA to get more supporting policies from the government. The business scale of foreign companies such as the Big Four should be limited step by step. ZHONGRUI

YUEHUA should strengthen its influence in local Chinese firms by its reputation. It is necessary to consider in building alliance with other middle-sized local firms under the current networks of ZHONGRUI YUEHUA. In this way, the market share can be increased in short time.

#### W-O strategies

ZHONGRUI YUEHUA was the merger of two different domestic accounting firms two years ago. Internal cooperation and conformity should be completed to resolve problems that new merged companies usually could have. ZHONGRUI YUEHUA should learn from the RSM the advanced skills in training and international business.

#### S-T strategies

The competition between ZHONGRUI YUEHUA and SHULUN PAN is supposed to be encouraged by the government. Only the strong competition can active and bring new concepts for all local Chinese accounting firms to get promoted. ZHONGRUI YUEHUA should make use of supporting policies by government effectively. By these policies, ZHONGRUI YUEHUA can enhance alliance with other qualifies local firms to expand current networks in China and further increase of market share. This is an effectual method to limit the expansion of Big Four in Chinese auditing market.

#### W-T strategies

A defensive plan should be set:

- 1 Cooperate with foreign accounting firm which is rival of the Big Four. This step has been completed.
- 2 Build an effective training system to prepare to increase qualified staffs which is the premise to accept more auditing and accounting business.
- 3 Organize training programmes to increase Chinese managers in senior administration level

## **VII. Conclusion**

### **Conclusion**

The thesis analyzed and discussed the possibilities for China to establish her own ‘Big Four’ accounting firms to compete and even challenge the Big Four group accounting firms. In order to focus on our studies, we set three core questions as followings for our research:

1. What are the environments (macro and micro) of Chinese audit market contribute to build local firms?
2. What is the position of the Big Four firms in Chinese auditing market?
3. How do Chinese big local accounting firms develop?

By researching these questions, we reviewed and studied China’s auditing situations and market in both micro and macro social-economic environments. We examined and studied the current problems and limitation of China’s domestic accounting firms. By case studies, we analyzed the policies used by China, cooperating with other international accounting firms, to compete with the Big Four. It is not enough for China to accomplish the plan to establish own strong ‘Big Four’ accounting firms only by performing new economic reform within 30 years.

As the research of the thesis, the increase of Chinese economy promotes the growth of capital market in China. As a member of the WTO, China is obliged to open more domestic markets, especially the financial service market. There are two stock exchanges on the Chinese mainland, Shanghai stock exchange with 864 listed companies and Shen Zhen stock exchange with 736 listed companies. These factors together provide an ever increasing expansion for the auditing business sector.

Since the Big Four entered into the Chinese auditing market in 2001, their market share has increased from around 37% in 2002 to around 52% in 2008 (Top 100

accounting firms). Whatever in the quantity and quality of staffs, the Big Four has absolute advantages comparing with domestic accounting firms. However, from 2006 to 2008, the market share of the Big Four almost has no changes. And there are no changes of the Big Four in market strategies.

Currently, Chinese domestic accounting firms still cannot challenge the Big Four, although a competitive market is slowly emerging in China. The biggest domestic accounting firms, ZHONGRUI YUEHUA and SHULUN PAN, have adopted a policy of cooperation with foreign accounting firms which want to gain a foothold in the auditing market. These foreign accounting firms have network members in international market such as the RSM International. Related department in China, the MOF, has realized the benefits which can be achieved from the cooperation between domestic and foreign accounting firms. The MOF encourages the new model of development of domestic accounting firms. We think that the concrete policies to support domestic firms will be issued in the future. The premise and opportunity for China to establish domestic Big Four group of accounting firms have been presented in Chinese auditing market.

In short time, the dominant status of the Big Four in China's auditing market can not be changed. It is impossible for China to support domestic accounting firms by legislation, which is against the principles by the WTO. Among the top 100 accounting firms in China, it is difficult for the domestic accounting firms to keep creating new mergers just to fall in line with the policy dictates of the government and whether or not ZHONGRUI YUEHUA and SHULUN PAN' actions and market tactics will be successful in the end in China.

### **Critique of the method used in the thesis**

In the part of case studies, we choose the Top 100 accounting firms in China which is

published by the CICPA annually. Comparisons are made between the Big Four and domestic 96 accounting firms. And there are comparisons between domestic Big 2 and the other 94 accounting firms. As mentioned in introduction, there are more than 4000 accounting firms in China at present. The analysis in the Top 100 accounting firms can not represent the whole auditing market in China even though the analysis based on Top 100 accounting firms are typical. But it is not practical to make research of 4000 accounting firms. And it is impossible to get authoritative figures about 4000 accounting firms in China.

In the thesis, related reports and figures about auditing firms are all cited from official website of government like the CICPA and MOF. Because of the bureaucratic system in China, national plans of development in auditing are not published in the website. For example, we found related records that domestic big accounting firms get supporting policies from MOF encouraging mergers to compete with the Big Four. But the detail contents of the policies are not available.

In the process of analyzing, it is important to have interviews with staffs in accounting firms and even authoritative departments. We contacted the CICPA and SHULUN Pan CPA in Shanghai by email and phone but unfortunately we never received any replies. We only had simple interviews with two friends who worked in related companies in China.

### **Suggestions for further studies**

The merger of China Rightson and YUEHUA and the cooperation between the ZHONGRUI YUEHUA and the RSM International indicate that domestic Chinese accounting firms have taken actions to prepare to compete with the Big Four in the future. If these strategies are successful, there will almost certainly be more mergers of different domestic accounting firms in China. We think that the merger could be a



strategy for domestic accounting firms. Otherwise, it is impossible for middle sized accounting firms to get large companies as clients. In this respect, we are concerned about how the Big Four will react and respond to this new threat to their market share. Another factor to be taken into consideration is to see what kinds of policies will be issued by related government such as the MOF. They will have important implications for both the domestic accounting firms and the Big Four.

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## Appendix I

Interviews with Mr. Zhu Ning who worked for the PwC before he came to Lund University for his Master studies:

Q1 What was your job when you worked in the PwC in China?

Zhu: I worked as an auditor when I worked in Tian Jin office of the PwC in China.

Q2 Did you and your colleagues have meals which were provided by your clients for free very often with your clients?

Zhu: We did not have these kinds of meals very often with our clients in China. Of course we had meals before a project was started (In China, one auditing for one company is called a project). This is normal way or ceremony for both parties to get to know each other. Normally we had this meal for only once.

Q3 Do you think that the independence and objectivity of auditing for your clients can be guaranteed without considering the market share and interests of PwC in China?

Zhu: Yes, I think so. With my experiences, I think that it is an effect way for us to know well about the company/client by more communications with our clients. It does not interfere the independence and objectivity of our auditing work.

Interviews with Mr. Li Xiao Meng who worked for the CS&S in China:

Q1 what was your job when you worked for the CS&C in China?

Li: I was soft engineer in CS&S Tian Jin office.

Q2 Did you once participate in programming software for accounting business?

Li: No. Our company once had cooperation with other company for ERP. Accounting function is only one part of the programme.

Q3 What were your impression on the use of computer in accounting when you



communicated with your clients?

Li: As I know, all the companies and accountants rely on computer and professional software of bookkeeping very much. Besides the software for accounting, also accountants use the Microsoft EXCEL very common.

As for the interviews, we can not say the interviewees and their statements are authoritative. We just want to demonstrate that the interviews are one of the information resources of our thesis. For each interview, we had discussion only for around 30 minutes. We only list three questions from the interviews of each person.

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