

## Reflections on Improving the Audit Independence of CPAs

Lin Jian\*

Fuzhou University of Foreign Studies, School of Finance, Fuzhou, Fujian 350202, China

\*Corresponding Author email: 35399608@qq.com

**Keywords:** Certified Public Accountant; Audit; Independence.

**Abstract:** Audit independence is the most basic requirement for CPAs to engage in audit work, and it is also the embodiment of professional ethics. Lack of audit independence means that audit lacks authority, which can easily lead to the decline of audit quality and make wrong audit conclusions. At present, more and more companies are issuing shares to finance in the securities market. However, a series of financial fraud cases of listed companies continue to occur, causing huge losses to investors. It also caused the public to start to have great doubts about the objective and impartiality of the auditing industry. The independence of auditing has gradually attracted the attention of the whole society. CPAs use their independent positions to conduct audit work and publish their own audit opinions on financial reports. Only by truly guaranteeing their independence can they play their actual role.

The CPA profession in western developed countries has been developed for hundreds of years, the auditing techniques and methods are relatively mature, and the auditing laws and regulations are relatively perfect. The Chinese CPA industry started later than Western countries, and it has not been very sound in the economic and legal environment. Therefore, by analyzing and researching the factors that can affect the independence of audit, this paper further proposes the solutions to improve the independence of audit, which has a certain practical significance for the auditing industry of CPA in China.

### 1. Introduction

Listed companies regularly disclose information to investors every year. Regular disclosure of financial report information is the most concerned part of investors. The company's assets, income and profits have a significant impact on investors' investment decisions and judgments. Stock prices are therefore most sensitive to this information. Senior managers have a better understanding of the company, while investors may have a slower understanding of the company, and there is information asymmetry with company personnel. It is likely that senior management will not disclose these important information or delay disclosure, or even use financial fraud to whitewash financial statements. In order to ensure the authenticity and reliability of the whole company's financial report information and prevent the company's insiders from using false financial reports to deceive investors, it is necessary to employ professional personnel to audit and verify the financial statements and increase the credibility. Such professionals are certified public accountants and certified public accountants as external personnel, through independent inspection of financial reports made by senior management of the entire company. From the perspective of more specialized, we can judge the truth of the financial statements, improve the quality of the company's financial reports, and provide reference for the economic decisions of outsiders. At the same time, it can also play a certain role in controlling the company's senior management.. Maintaining independence is the most basic requirement of CPA personnel. Only by insisting on independence can the audit work be carried out normally, and the CPA profession can survive. There are many financial fraud cases in the current capital market. From the early cases of Yinguangxia, to the recent Green Earth, Jinya Technology and Xintai Electric, etc., the occurrence of these cases has caused the public to doubt whether the audit

work is independent and effective, and has produced a great deal for the CPA profession. influences. Therefore, it is necessary to carefully study the factors affecting the independence of auditing, so that CPAs can conduct audits in strict accordance with auditing standards, conduct independent audit work, and abide by professional ethics.

## **2. Audit independence**

The CPA audit is also called independent audit. It is an activity that the CPA accepts and provides professional services to the audited entity. The property owner puts the assets into the company, and because of his limited ability, he entrusts others to operate, and the ownership and management rights are separated. Objectively, it is necessary to hire independent third-party personnel to conduct audits and effectively restrict the operating personnel. The essence of audit lies in independence, lack of independence, it is difficult to maintain objective and impartial audit work, audit will lose its significance. In China's Code of Professional Ethics for Certified Public Accountants (CPAs), it is pointed out that CPAs should carry out audit work independently of the client and the auditee. The independence here mainly refers to two aspects: formal independence and substantive independence.

### **2.1 Formal independence**

Formal independence is external performance and tangible independence. Social audiences can judge whether CPAs and auditing clients are independent according to superficial phenomena. There seems to be no interest relationship and economic interest relationship between the CPA and the principal. If the public is found to be more biased toward the principal or company executives according to their daily behavior, and issue a false audit report, then the formal independence will be impaired. In this case, the CPA should evade.

### **2.2 Substantial independence**

Substantial independence is an intangible independence. In the process of conducting audit work, CPAs perform audits in strict accordance with auditing standards, formulate reasonable audit plans through risk assessment, and use audit procedures to collect and evaluate audit evidence. Only through careful analysis of major audit issues, without any interference from internal or external factors, objective and impartial, using facts as the basis to form and express credible audit opinions, can such audit conclusions be credible.

Generally speaking, substantive independence and formal independence are not exactly the same, but they are also related to each other. In the whole process of auditing, CPAs should maintain their independence in form and avoid the suspicion of the public. Formal independence is a guarantee of substantial independence. Substantial independence is independent of formality.

## **3. The main reason for the lack of independence of CPA audit**

### **3.1 Audit market imbalance**

According to the website of the Chinese Institute of Certified Public Accountants, as of March 31, 2018, there were 8,674 accounting firms nationwide, including 7,583 general offices and 1,091 branches. There are 105,892 CPA practicing members and 134,863 CPA non-practicing members. The total number of individual members exceeds 240,000, reaching 240,755. In 2017, the industry's income reached 91.8 billion yuan.

From the above data, we can see that the whole industry income of the firms is not low, the average business income of each firm reaches 10 million yuan (91.8 billion yuan/8674). However, in fact, most of the 8674 accounting firms belong to small and medium-sized local accounting firms, and their own business ability is very limited. The business mainly relies on the income of certification business in statement audit, while other non-certification business income in management consulting, tax service and business training is basically blank. Small firms themselves are relatively short of talents in this field, and it is not easy for them to carry out business on this side, which leads to

competition between small and medium firms, and even solicit business at low prices, and their survival is facing crisis. In addition, the business income of small and medium-sized firms comes from a number of major customers. Under such a significant economic interest relationship, small and medium-sized firms tend to yield to customer pressure and undermine their independence. The large-scale accounting firms have a large number of employees, and they can engage in a wide range of business, according to the information of the top 100 accounting firms in 2017. Deloitte's accounting for auditing services in this area reached more than 2.7 billion yuan, while non-audit business such as tax services and consulting services reached more than 1.2 billion yuan. The total annual income has reached 4 billion yuan, so that it can absorb more high-quality employees, and the income from single customers is not high in the business income of the firm. Audit independence is better, but the larger portion of the firm's business revenue is still dependent on attestation revenue.

Table 1 Ranking of business income of accounting firms in 2017

Name	Gross business income	Authenticated business income	Non-certified business income
PWC	51695	468141	48454
Deloitte	402977	275058	127918
Lixin	369015	318703	50311
An Yonghuaming	332337	315129	17207
kpmg	312685	260753	51931
Ruihua	287998	262338	25660
Tianjian	223706	217029	6677
Dahua	155012	132891	22120
Identical with	154902	120899	34002
Xin Yong Zhong	134831	119028	15803

### 3.2 Independence between CPAs and customers

In the process of carrying out the whole audit business, the auditing client, the auditing client and the auditing object are indispensable. They check and balance each other, so that the whole audit business can be carried out completely. China's listed companies have not yet formed a good governance structure. On the surface, the shareholders' meeting, the board of directors, the board of supervisors and the management are working well. In fact, state owned shares account for a large proportion of state-owned listed companies, mainly by senior management. For the listed companies of private enterprises, the large shareholders who hold the controlling rights control the listed companies, and the special phenomenon of "one share is dominant" makes the right of appointment of accounting firms all in the hands of senior management or major shareholders. There is a phenomenon that the auditor and the auditee are united. The principal and the audited entity lack independence. Whether the CPA will be hired, audit fees, and the payment method or even the fee structure are all in the hands of the major shareholder or company management. Therefore, they choose the corresponding accounting firm and certified public accountant for their own interests. If the auditor's audit report does not meet the expectations of such personnel, it is likely that the audit business will not be completed. Faced with such economic interests, for small and medium-sized firms, they are often in a relatively passive position. In the current situation where government agencies are not punitive, it is generally difficult to maintain independence. For example, in the audit process of Greenland listed companies, Shenzhen Pengcheng Certified Public Accountants not only corrected various financial irregularities, but also helped the company to whitewash financial statements. After that, Zhonghe Zhengxin Certified Public Accountants did not carefully check the false materials, and did not carefully analyze the abnormal situation, and issued an unqualified audit

report.

### **3.3 Supervision and punishment mechanisms are not sound**

Although with the continuous strengthening of China's securities supervision, most companies that have falsely reported profits and falsified listing information have been exposed. However, in addition to being directly condemned by the accounting firm and directly penalized by administrative penalties and criminal penalties, very few of them will be liable for civil liability for all losses. The shortcomings of such legal operation are quite obvious, and it also causes a very important reason for the lack of civil legal proceedings against CPAs in China. So far, China's civil liability for violations of laws and regulations in the securities market has not yet had a set of specific operational norms that can be used to bring civil suits, and the qualifications of civil litigation entities. The legal elements of civil liability, the principle of imputation, the allocation of burden of proof, the limit of compensation for loss and the allocation of liability for compensation for loss are still under constant debate. In the case of audit fraud of Green Earth, the signature accountant of Shenzhen Pengcheng Accounting Firm was warned and fined 100,000 yuan. The firm confiscated only 600,000 yuan and fined 600,000 yuan, relative to the profits obtained. External punishment is obviously too light, which not only does not really deter the relevant personnel, but may make later generations pay less attention to professional ethics and violate audit independence.

## **4. Suggestions on Improving the Audit Independence of Certified Public Accountants**

### **4.1 Standardizing Audit Market**

Accounting firms are facing fierce competition. There is no government financial allocation for their daily operation. They are responsible for their own profits and losses. They also need to weigh costs and benefits. If there is a price war between them, it will inevitably lead to losses. At the same time, the lower the audit fees, it often means saving audit procedures and reducing audit quality. Therefore, the government regulatory authorities should intensify efforts to create a relatively reasonable and fair market competition environment. Firstly, there are a large number of firms. We can establish partnership firms by optimizing the combination and strengthening the joint venture. We can guide the firms to expand their scale and enhance their ability to resist risks. At present, the CPA Association of China publishes the firms whose business income ranks in 100 every year. In 2017, the firms ranked in the 100th place get business income of 31.18 million yuan. There are 20 CPAs. Compared with many small and medium-sized firms, which are still competing for thousands of yuan in audit fees, these firms obviously have great market competitiveness. After the enlargement of the size of the firms, with the increase of business income, the importance of a single customer in the firms decreases greatly, and the bargaining power of the firms and auditing customers also increases greatly. Considering the cost, it will not arbitrarily reduce the price, but also help to improve the audit quality. With the increase of the firm's income, more high-quality personnel can be recruited. Strengthen training and management, strive to develop non-authenticated services in tax planning, enterprise consultation, etc., and expand the scope of business. Secondly, the government departments should improve the audit fees. Auditing work is different from other work, which is difficult to quantify. The government supervision departments should make a full investigation and make a reasonable formulation of the fee standards. Excessively low audit fees mean that necessary audit procedures are reduced and audit quality is difficult to guarantee. Therefore, it is suggested that audit fees should be filed with relevant departments when audit reports are issued. Financial departments, securities regulatory bodies and CPA associations should inspect audit fees of various firms, and find that too low audit fees should strictly manage the firms and audit projects, so as to prevent individual firms from disrupting the whole audit market in order to win customers.

### **4.2 Ensuring the independence of CPAs and customers**

The shareholding structure of listed companies needs to be further regulated. It is necessary to

change the situation of “one big share”, so that shareholders can mutually restrict each other, and the shareholding ratio of major shareholders should be reduced. It is impossible for one person to control the shareholders' meeting and the board of directors. In turn, the company's management is controlled to ensure the right to information and voting rights of small and medium-sized shareholders. The choice of accounting firms is decided by the shareholders' meeting to discuss and decide. The major shareholders can only have partial voting rights or even avoidance systems. In view of the absence of shareholders of state-owned listed companies, the state-owned assets supervision department may appoint reasonable personnel to serve as the chairman of the board of directors, and choose the accounting firm to conduct audits on its own, instead of selecting the firm by the management of the listed company. Generally, listed companies have audit committees. The members of audit committees are usually professional personnel, who communicate directly with the problems found in the process of CPA audit. Coordination between accounting firms and management departments may occur some conflicts, understanding the audit process and through effective communication, can solve some problems found in the audit. Evaluate the accounting firm and decide whether to renew it, etc.

To strengthen the professional ethics education of certified public accountants, every year certified public accountants should receive a certain amount of continuing education, and certified public accountants associations and firms should regularly organize professional training of certified public accountants. In the process of training, it is necessary to introduce more relevant cases of audit independence, so that CPAs can deeply understand the importance of enhancing independence and improve the level of professional ethics.

#### **4.3 Strengthen supervision**

In recent years, the audit of certified public accountants has failed, and the occurrence of false audit reports has often occurred. The government regulatory authorities have also issued a number of laws and regulations, but the results have been minimal. The main reason is that the illegal gains are far greater than the illegal costs, which will encourage a considerable part of the illegal activities. Therefore, the Securities Law and the CPA Law should further clarify the legal liability of CPAs for violating professional ethics. Simple market ban for three years and small amount of fines do not play its due role, we should increase the cost of violations to promote conscious compliance of this part of the staff. At present, the auditing of listed companies involves the Ministry of Finance, the Securities Regulatory Commission, the Stock Exchange and the Association of Certified Public Accountants and other government agencies. These regulatory departments should cooperate with each other to strengthen coordination and communication.

#### **Acknowledgement**

The school-level topic of Fuzhou Foreign Language and Trade College is "Teaching Reform and Exploration of Audit Practice Course" (JF2018051).

#### **References**

- [1] Wen L, Hao Q, Bu D. Understanding the Intentions of Accounting Students in China to Pursue Certified Public Accountant Designation [J]. Accounting Education, 2015, 24(4):341-359.
- [2] Ariail D L, Abdolmohammadi M J, Smith M. Ethical Predisposition of Certified Public Accountants: A Study of Gender Differences [J]. Social Science Electronic Publishing, 2014, 16(2012):29-56.
- [3] Francalanza C, Buttigieg E. Maltese certified public accountants and whistle-blowing: traits, influences and propensity [J]. Journal of Applied Accounting Research, 2016, 17(3):262-284.
- [4] Schoenfeld J, Segal G, Borgia D. Social cognitive career theory and the goal of becoming a certified public accountant [J]. Accounting Education, 2018, 26(2):1-18.

- [5] Dailey M. A White-Collar Profession: African American Certified Public Accountants since 1921 (review) [J]. *Enterprise & Society*, 2015, 4(4):969-970.
- [6] Wang W K, Lu W M, Kweh Q L, et al. Does intellectual capital matter? Assessing the performance of CPA firms based on additive efficiency decomposition DEA [J]. *Knowledge-Based Systems*, 2014, 65:38-49.