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An Insight into the Institutional Setting of China: Evidence from China's Recent Structural Reforms

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Abstract

This report examines the impact of China's market developments on the accounting industry over the period 2003 to 2014. In this period China initiated the Split-share Structure Reform (SSSR) to privatise Local State-owned Enterprises (LSOEs). Moreover, China announced "Document 56" with the aim of developing its domestic accounting industry. Overall, the report casts light on China's recent structural reforms and how they, in turn, improve the development of the accounting industry in the country. It summarises the differences between China's institutional setting and the more western capitalist economies such as the UK and the US.

Keywords: *China Market , SSSR , Document 56, improve .*

Introduction

This report introduces the institutional setting of China in light of its structural reforms that aim to create a more market-oriented economy in the country, an economy more similar to other more developed capitalist markets like in the UK and the US. In particular, this report explores the distinctive features of state capitalism in China and its reforms over the last few decades, following a threefold analysis of the structural changes in the Chinese market, as follows. First, it introduces China's state capitalism and the power of the single ruling party that dominated the Chinese economy until the 1990s. It also summarises the main structural reforms that aim, in turn, to allow private investors to actively engage in the financial markets.[2]

Second, it highlights the financial and audit markets development in China that converge China's national accounting standards with the International Financial Reporting Standards (IFRS) and International Standards on Auditing (ISA).[3] It also highlights the deregulation of the audit market,

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[2] China launched two financial stock markets in Shanghai and Shenzhen in 1990 and 1991 respectively as an attempt to allow private investors to trade actively in the financial market on a split-share structure basis between tradable and non-tradable shares.
[3] China's accounting standards convergence with IFRS started in 1992 in four stages starting with the introduction of GAAP. The convergence with IFRS was accomplished by the end of 2006 (Peng and Smith, 2010).

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through the Auditor Disaffiliation Programme.[4] In addition, it explores China's efforts to develop its domestic accounting industry. Lastly, yet most importantly, this study sheds light on the market development differences across China's 31 provinces.

The literature survey provided in this report raises a number of empirical research questions. First, it highlights the market segmentation of Chinese listed firms based on ownership (i.e., SOEs and NSOEs).[5] SOEs are controlled by the various levels of government, whereas NSOEs are controlled by individual and institutional private investors. It also identifies three types of audit firms that provide audit services for these firms (i.e., the international Big 4 audit firms, the domestic Big 6 Chinese audit firms and other small domestic audit firms).[6] Hence, it raises the empirical question; does ownership structure affect auditor choice? Moreover, how do market development and the other structural reforms that took place over the past few decades affect auditor choice in China?

The other main empirical question that is raised from the literature survey is an investigation into auditor independence in China in the light of China's institutional setting and its recent reforms. Finally, the literature survey provided in this report raises the empirical question of how ownership structure and its reforms affect the pricing of audit services in China and, hence, audit quality.

1. Theoretical Background

The industrial revolution in the 1760s led to the need for the division of labour, which was first discussed by Adam Smith in 1776. Since then, the division of labour is believed to have affected the efficiency of businesses positively and, hence, caused structural reforms in the organisational hierarchy (i.e., the separation between management and ownership). Management separation from ownership means that managers are employed as external agents to the principals (owners) in order to achieve specific goals (DeAngelo, 1981). Jensen and Meckling (1976) suggest an agency problem when principals engage agents (management) to act on their behalf. With the agent obtaining the authority to act independently, a separation between ownership and management creates the opportunity for agents to act differently from the achievement of the principals' goals, to maximise their own interests. Agency theory suggests the means to control for any potential conflicts of interest between these two parties.

DeAngelo (1981) argues that audit as an oversight tool is demanded in order to control for any potential conflicts of interest between managers and stakeholders. The demand for and the supply

[4] In the period between 1997 and 1998, China removed the subscription of audit firms to the state in the attempt to improve the accounting industry and auditor independence in the country (Gul et al., 2009).
[5] SOEs are then divided into Local SOEs and Central SOEs based on the level of government that exerts control over the firm (i.e., the central government and other local governments).
[6] Previous studies that investigate audit types in China often classify audit firms into two groups (i.e., Guedhami et al. (2009) and Guedhami et al. (2014) use the international Big 4 vs all other firms; Chen et al. (2011) use the largest eight firms vs all other firms; Wang et al. (2008) use the largest 10 firms vs all other firms (i.e., the international Big 4 and the six largest Chinese firms); and Yang (2013) and Liu and Subramaniam (2013) use the largest 14 firms (i.e., the international Big 4 and the 10 largest Chinese firms) vs all other firms.

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of audit quality, however, depends upon the incentives and competences of the client and the audit firm (DeFond and Zhang, 2014). Nonetheless, managers as agents are motivated to hire high quality audit firms to either show competence in presenting financial statements or to satisfy stockholders' demand for a third party to monitor managers' decisions. In her important paper, DeAngelo (1981) argues that audit quality is not independent from audit firm size, leading to many research papers that, in turn, try to measure audit quality (Bartov *et al.,* 2000; Gul *et al.,* 2009; DeFond and Zhang, 2014).

One common definition of high audit quality is "a greater assurance that the financial statements faithfully reflect the firm's underlying economics, conditioned on its financial reporting system and innate characteristics" (DeFond and Zhang, 2014, 276). Audit quality is associated with the amount of information that is relevant for decision-making, about the firm's financial performance, and which is available for decision-makers (Dechow *et al.*, 2010). More informative disclosure helps investors make decisions using more accurate predictions and forecasts (Healy and Palepu, 2003). In theory, audit firm size, audit firm specialisation, audit fees and the propensity to issue a modified audit opinion are associated with higher audit quality and higher auditor independence (Bartov *et al.,* 2000; Gul *et al.,* 2009).

One other theory that deals with information asymmetries between managers and owners is signalling theory by (Spence, 1973). Signalling theory analyses the behaviours of agents as a consequence of the information gap between the managers and the owners of the firm. In order to signal a reduced information asymmetry, management will disclose more information and use high quality audit firms that, otherwise, will uncover any material misstatement in the financial statements. This theory, however, assumes the existence of an efficient market, where wrong financial reporting signals will damage managers' reputations. It also, along with agency theory, assumes that agents' incentives to conceal or falsify financial statements are solely to maximise self-interest. These theories also discuss the conflicts between agents and principals of the firm, in an environment where maximising self-interest dominates the market.

In China, however, the conflict could be more pronounced between the owners, themselves, rather than with the managers, as the state uses its influence over firms to ignore the interests of the minority shareholders (i.e., private individuals and institutional investors) (Lu and Fu 2014). Moreover, in China, audit research is mainly focussed on corporate governance mechanisms, and how they affect the audit firms. In particular, how does ownership structure, in a country where the state dominates the market, affect the accounting industry. This includes studies on ownership structure and auditor choice (Wang *et al.,* 2008; Guedhami *et al.,* 2009; Lin *et al.,* 2009; Liu *et al.,* 2016), auditor independence (DeFond *et al.,* 2000; Gul *et al.,* 2009; Chi *et al.,* 2013; Bandyopadhyay *et al.,* 2014) and the level of audit fees (Hu *et al.,* 2012; Liu and Subramaniam, 2013; Leung and Cheng, 2014). For example, Wang *et al.* (2008) show that, compared with NSOEs, SOEs can use political power to affect firms' audit choice, also accessing private management information. Such

effects lead to different agency costs and different incentives towards signalling based on the ownership structure e.g., signalling better infrastructure and employment rates to increase the likelihood of receiving promotions regardless of firm performance.

These unique characteristics of the Chinese institutional setting, along with the structural reforms during the last decade, raise the question of whether or not these traditional theories apply in China. For example, it is not clear whether maximising firm value is the ultimate goal for a firm that is owned by the state. On the contrary, it might be more reasonable to assume that managers of these firms will be concerned more about the stability of the region, such as infrastructure and employment rates (Shen and Lin, 2009).

2. China's State capitalism

The Chinese market is different from capital-based economies in that many of its firms are sponsored or administered by state agencies at various levels of the government (Wong, 2016). However, several reforms intended to open the Chinese market to both private and foreign investors have occurred since 1979 when China first introduced SOEs to replace government ministries (Chen, 2013). Furthermore, China launched the Shanghai and Shenzhen stock exchanges in the early 1990s to allow private and institutional investors to enter the financial market.[7] Since then, private investors have been allowed to trade in newly issued shares, although typically leaving them as minority shareholders with a total share of less than one-third of total share capital. Meanwhile, the majority of shares were held by the state at its various levels and were not allowed to be traded in the financial markets (Lu and Fu, 2014). During that period, political connections in China were crucial (e.g., the need for China Securities Regulatory Commission (CSRC) approval before any initial public offering (IPO)). Such connections resulted in private firms also establishing political connections to facilitate IPO listings (Lu and Fu, 2014).

The Chinese stock market, following the Split-share structure, was divided into tradable and non-tradable shares. Both hold the same cash flow and voting rights. Non-tradable shares, however, were held by the state or legal person investors, and they could only transfer ownership upon pre-approval from the Securities Regulatory Commission (SRC). The price was set based on the book value of the firm instead of the market share price. Hence, the primary source of income for the holders of non-tradable shares was dividends, and they were less concerned about the market value of the firm.

Tradable shares, on the other hand, were held by minority private investors and could be traded openly on the stock market. Tradable shares consisted of: 1) A-shares traded domestically by individuals and denominated in RMB currency; 2) B-shares also domestically listed of China-incorporated companies, but denominated in USD for Shanghai Stock Exchange and HKD for

[7] The newly launched stock exchanges were the first step to create NSOEs that are controlled by private individual and institutional investors on a split-share structure basis upon the issuance of new shares.

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Shenzhen Stock Exchange; and 3) foreign shares, listed outside Mainland China (i.e., H-shares listed on the Hong Kong stock exchange, N-shares listed on the New York Stock Exchange and S-shares listed on the Singapore Stock Exchange). Until 2001, only domestic investors were allowed to trade in A-shares, while foreign investors could only trade in B-shares. By the end of 2002, however, both domestic investors and Qualified Foreign Institutional Investors (QFIIs) were allowed to trade in both types. As a result, the latter required higher standards of corporate governance leading, in turn, to improved audit effectiveness in the country (Leung and Cheng, 2014).

3. Share Issue Privatisation

The Split-share structure dominated the Chinese financial market until 2005 when the state introduced the SSSR. The SSSR aims to convert all non-tradable state shares into tradable A-shares that can be traded freely in the financial markets. The SSSR aims to improve the pricing of China's capital market, empower free market control over listed firms, and restructure LSOEs into NSOEs with an ultimate goal of maximising firms' value (Joyce, 2008). Empirical research shows that, on the one hand, this partial privatisation is associated with higher firms' value, better information transparency and higher audit quality (Wei *et al.* 2005; Wang *et al.* 2008; Gul *et al.* 2009). On the other hand, privatisation weakens a firm's political connections and, hence, reduces its IPO opportunities and negatively affects share prices as the firm will lose the benefits offered by government bailouts in times of financial distress when it goes public (Francis *et al.,* 2009; Calomiris *et al.*, 2010).

The SSSR, however, was applied in stages upon the reaching of a consensus between tradable shares shareholders, who held two-thirds or more of the total tradable shares, and non-tradable shares shareholders on a proposal summarising the procedures of the reform and the compensation to be given to tradable share shareholders (i.e., cash or shares reallocation). After approval of the reform plan, non-tradable shares shareholders are not allowed to trade for one year; then, one year later, they are allowed to sell a maximum of 5% of their share, and no more than 10% of the total shares two years following implementation. This survey presume that the SSSR takes effect on the date when the reform plan is approved. By doing so it is considered that once the state agrees on the reform plan, the state-shares will become tradable subject to the reform plan restrictions, and their value will be determined based on the financial stock markets' price.

In 2004, before the SSSR, 60% of total shares were non-tradable (of which 56% were state shares). By the end of 2009, when the SSSR was almost completed, only 18% of total shares remained non-tradable. Despite the completion of the SSSR in 2010, however, the state still maintained ownership of 53% of shares, while the other 47% were allocated between individuals, institutional investors and private firms (Piotroski and Wong, 2012). Nonetheless, following the State-owned Assets Supervision and Administration Commission (SASAC) "Guidance for Promoting State-owned Assets Adjustment and State-owned Enterprises Reorganization" the state, gradually and steadily

over time, sought to sell its remaining ownership in firms falling in industries other than national defence, infrastructure, mineral resources, common products and hi-tech industries.

4. China's Audit Market Reforms

The Chinese Institute of Certified Public Accountants (CICPA), supervised by the Ministry of Finance (MOF), was founded in late 1988 in order to examine and develop professional standards and regulations for CPAs in China. The responsibilities for the CICPA are to manage CICPA memberships, conduct annual quality assurance for the profession, organise CPA examinations and to give guidance that supports CPAs to adhere to Chinese laws and regulations (CICPA, 2014). The Chinese government, through the MOF and the CICPA, has taken several steps to develop the accounting profession in China.

First, the MOF and the CICPA launched the Auditor Disaffiliation Programme between 1997 and 1998 to eliminate the subscription of audit firms to local governments in order to improve auditor independence where audit firms were closely affiliated with local governments in the early 1990s until China adopted the International Auditing Standards as in 1995 that comply with the ISA (Lu and Fu, 2014).

Gul *et al.* (2009) investigated whether the Auditor Disaffiliation Programme in 1997 has actually improved auditor independence. They study a sample of 1,248 Chinese listed firms through the period 1995 to 2000, and they find that subsequent to the completion of the disaffiliation programme, the likelihood of issuing a modified auditor opinion (MAO) increased substantially. They also report that small audit firms were affected by the disaffiliation programme more than big reputable audit firms (i.e., Big 10 Chinese audit firms). Gul *et al.* (2009), moreover, highlight an improvement in earnings quality after the disaffiliation programme, using non-core operating earnings as a proxy to measure earnings management behaviours.

China continued with the institutional changes aiming to improve auditor independence in 2000, when more restrictions were added for audit firms wishing to qualify for the performance of audit services for Chinese listed firms. For example, only CPA firms with more than 20 qualified CPAs, or revenue of more than 8 million RMB in the previous year, can provide audit services to listed companies (Lu and Fu, 2014). As a result of these reforms, a wave of audit firm mergers occurred in the country, where large audit firms acquired or merged with smaller audit firms, thereby creating bigger audit firms that are no longer considered as regional firms which, in turn, changed the structure of the Chinese audit market (Hu *et al.*, 2012).

In 2004, moreover, China implemented a Mandatory Auditor Rotation (MAR) requiring firms to change the signing auditor every five years, with a cooling off period of two years, in an attempt to maintain higher auditor independence. For Central SOEs, the SASAC issued two rules in 2004, making the SASAC responsible for assigning auditors for Central SOEs, and requiring them to retain auditors for 2-5 consecutive years (Gillis 2014, 253). Moreover, the National Audit Office

(NAO), in 2006, obtained the authority and responsibility to oversee auditing of SOEs following Article 7, 8, 17, and 41 of the revised Audit Law of the People's Republic of China in February, 2006 (Audit Law of the People's Republic of China, 2006). Article 1 of the revised Audit Law of the People's Republic of China, summarises the aims of these reforms as follows: "To strengthening State supervision through auditing, maintaining the fiscal and economic order of the country, improving the efficiency in the use of government funds, promoting the building of a clean government and ensuring the sound development of the national economy and society".

More recently, in 2011, the MOF issued more guidelines encouraging LSOEs to appoint audit firms among the top 50 in order to have an auditor tenure longer than five consecutive years.[8] In 2006 China started the adoption of National Accounting Standards (NAS) that converged with the ISA. In 2011 the EU Commission "Decision 2011/30/EU1" declared China amongst the 10 nations that follow an equivalent audit oversight regime (the other nine countries comprise: Australia, Canada, Croatia, Japan, Singapore, South Africa, South Korea, Switzerland, and the United States) (Kleinman *et al.,*2014).

In 2009, China started a major structural change in the audit market to develop its domestic accounting industry. In order to create a domestic accounting industry capable of competing with the international Big 4 audit firms, State Council, the highest executive institution in China, issued "Document 56", a policy that provides "A Number of Opinions on Accelerating the Development of Certified Public Accountants" (Gillis 2014, 242).

Document 56 sets out a five-year strategy to set up a structure of (7000-200-10) Chinese accounting firms as follows: : i) small audit firms that can provide services to Chinese small enterprises and those in rural areas; ii) medium-sized firms that can provide audit services to medium and large Chinese listed firms; and, finally, yet most importantly, iii) large audit firms that can run cross-border operations and provide high quality audit services to China's large firms, and are capable of competing with the international Big 4 audit firms (Gillis 2014, 243).

The government's effort to create large Chinese audit firms capable of competing with the international Big 4 audit firms was translated in two ways. On the one hand, the government provided a numerous range of services and support to Chinese large audit firms (i.e., research and development, investment promotions and foreign exchange). It also encouraged them to expand their cross-country operations and partnerships. On the other hand, the MOF issued "Caikuai, No. 8" Notice on Issuing the Scheme on the Localised Restructuring of Sino-Foreign Cooperative Accounting Firms, in 2012 which specifically targets the international Big 4 audit firms and provides guidance on the requirements and procedures of how to convert into special general

[8] The CICPA provides a ranking for the Chinese top-100 accounting firms that is published annually on their official website (see Appendix B).

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partnerships after their joint venture expired in the years 2012 and 2013 (Jui and Wong, 2015).[9]

Gillis (2014, 243) summarises the requirements of "Caikuai, No. 8" for the international Big 4 audit firms to continue their operations in China in the form of special general partnerships as follows: i) it should include 25 partners with a minimum of 100 CPAs and a capital of 10 million RMB; ii) CPA partners should have five years of experience at least three years of which should be in China; and, iii) partners should not have disciplinary proceedings against them. Hence, audit firms, in order to perform audit services in mainland China, are required to obtain a license from the MOF that can be renewed periodically. Licensees are required, under the oversight of the MOF, to comply with China's regulations and, in particular, the state secrets laws (i.e., Chinese companies' records cannot be taken outside China or shared with third parties outside the license). Any breach can lead to penalties by the MOF that can include a temporary suspension of the audit firm license (Jui and Wong, 2015).

The structural reforms in the Chinese accounting profession create a setting that is different from audit markets in more developed western markets like the UK and the US. In the latter markets, a large number of firms are audited by 'reputable' audit firms (usually regarded as the Big 4 international audit firms). In contrast, the audit market of China is diffused (Lu and Fu, 2014). By mid-2014, there were around 100,000 practising CPAs in China with more than 8,000 audit firms providing audit services to approximately 3.5 million enterprises around China, of which there are 2,537 listed firms (CICPA, 2014). In the same year, the percentage of firms audited by the 10 biggest Chinese firms, based on the CICPA ranking, was 64% of listed firms. However, the international Big 4 audit firms audit only less than 5% of listed firms and the remaining percentage of 31% of listed firms receive audit services by other medium-sized and small Chinese audit firms. After the announcement of Document 56, it is conjectured that the market share of Chinese big audit firms will further increase at the expense of the international Big 4 audit firms.

5. China's National Accounting Standards Convergence

Along with China's efforts to create a more market-oriented economy, China also worked on the convergence of its national accounting standards with the IFRS. By doing so, China aimed to develop a financial market comparable to more well-developed capitalist economies (Lu and Fu 2014). With guidance from the International Accounting Standards Committee[10] (IASC), China worked on harmonising national Generally Accepted Accounting Standards (GAAPs). Peng and Smith (2010) summarise the process of China's national accounting standards convergence with the IFRS throughout the period from 1992 to 2006 in four stages as follows.

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[9] The international Big 4 audit firms entered the Chinese audit market through the establishment of joint ventures with domestic Chinese audit firms in the early 1980s (Gillis 2014, 77).

[10] The main objectives for the IASC being to create standards that can: i) serve as a model for national standards setters to build on, ii) restrict the range of acceptable methods of accounting for certain types of transactions, iii) provide broad principles that have some flexibility so they do not conflict with the national standards applied, and iv) create standards that are more descriptive than prescriptive (i.e. guidelines of what is acceptable) (Pacter, 2005).

First, the MOF[11] started a series of regulations including the introduction of GAAP in 1992. The second stage of development started in 1998 when the MOF added another 10 Chinese Accounting Standards (CASs) to the 1992 GAAP in order to enhance the level of protection for investors as a result of the rapid development of the capital market. The convergence process with IFRS continued in 2001 when the MOF introduced another 16 CASs and applied the Accounting System for Business Enterprises (ASBE) to replace the GAAP of 1998. The fourth and final stage, in 2006, was through importing an additional 36 items that were taken directly from the IFRS, making the CASs 77% successfully converged with the 2006 GAAP which became effective by 2007.

After the 15-year strategic plan to converge China's national accounting standards with IFRS, many studies investigate the effects of this evolutionary reform (Ding and Su, 2008; Peng *et al.*, 2008; Peng and Smith, 2010). The majority of the previous studies use the year 2007 as the cut-off point that divides the *pre-* and *post-*China national standards convergence with the IFRS. Among the early studies on the convergence with the IFRS in China, Peng *et. al.* (2008) study both firms' compliance with accounting regulations, the consistency of firm's choices between the two sets of regulations (i.e., China's national standards and IFRS) and how the regulation change affects net income figures. They use a unique sample of Chinese firms that issue both A and B-shares, over the period between 1999 and 2002. Hence, the same firm was producing annual reports using a different set of accounting standards (i.e., China's national accounting standards (China GAAP) for A-shares and the IFRS for B-shares). The findings are that, despite incomplete compliance with the IFRS, there remained a significant improvement in compliance, consistency and comparability of financial statements.

More recently, Liu *et al.* (2011) provide evidence that the last stage of China's GAAP convergence with the IFRS in 2006 also contributes to improving overall accounting quality. Using data from 3,240 firm-year observations for the period 2005 to 2008, they report higher quality in reported accounting measures accompanied by decreasing income smoothing practices and increasing value relevance.

6. Market Development Across Mainland China

This section summarises the diversity across China's different regions. The National Economic Research Institute (NERI) issues an index of marketisation that shows how China's provinces differ from each other (see Appendix A). The report includes indexes conducted by Fan and Wang (2003) that divide overall market development scores for each province into five main subcategories, each of which combines a number of attributes that, together, determine the total score as follows: 1) the Credit Market Development Index that measures the percentage of deposits taken by non-state financial institutions and the percentage of short-term loans to the non-state sector; 2) the Government Decentralization Index that reflects: (a) the provincial government's

[11] The MOF is the government entity that is entitled to establish Chinese accounting standards.

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spending as a percentage of provincial GDP; (b) the tax rates in the province; (c) the time spent by entrepreneurs in dealing with the bureaucracy; and d) the time needed for firm registration and to obtain various licenses; 3) the Legal Environment Index, constructed based on: (a) the number of lawyers as a percentage of the provincial population; (b) the efficiency of local courts measured by the percentage of lawsuits pursued by the courts; and (c) the protection of property rights; 4) the Product Market Index including measures for the market effect on prices and government local producer protection; and 5) the Factor Market Index with proxies to reflect financial liberalisation, market competition and foreign investment.[12]

These five categories, combined, create a Market Development Index score (MDI) for each province that varies across regions and over time, and where the existence of laws and regulations does not necessarily mean a developed legal enforcement that is effective in practice. In particular, many laws and regulations in China are not enforced effectively due to the power of the single ruling party (Allen *et al.,* 2005; Cai 2007). Moreover, the weak legal infrastructure in China (e.g., no private securities litigation against accounting frauds) weakens capital market development (Piotroski and Wong, 2012; Gillis 2014). Since 2001, however, the regulatory agencies in China have pursued several public enforcement actions (e.g., in 2002, the Supreme Court started to accept civil lawsuits against false financial statements) which, in turn, helps to improve China's legal environment (Chen *et al.* 2010).

Summary and Conclusion

This report has examined the China economic setting and how it is different from more developed capitalist markets such as the UK and the US. It summarises China's evolutionary developments at the financial level, starting with the introduction of SOEs to replace government ministries' financial control in the late 1970s. It also traces the share issue privatisation started in the early 1990s which was accomplished by 2009 following the SSSR. Finally, it describes the convergence of China's national accounting and auditing standards with international standards (i.e., the IFRS and ISA), and the introduction of Document 56.

This study, also, is suggestive of a number of empirical research questions. First, it suggests a firm's auditor choice can be a function of ownership characteristics and other China-specific features (i.e., structural reforms and differences across China's different regions). Second, it suggests an empirical question of whether these reforms improve auditor independence. Finally, it suggests the question of how ownership structure and market reforms affect audit quality in China. It also suggests future research topics that can link these market reforms to other research areas (i.e., corporate governance, earnings management and corporate social responsibility).

In summary, this report introduces China's state capitalism and how the financial and audit markets were regulated under the power of the single ruling party until 1978 when decentralisation strategies

[12] These proxies are designed by Fan and Wang (2003) and published periodically by the NERI.

took place, and SOEs came to exist. It then summarises the remaining phases of the market deregulation through the introduction of NSOEs in the early 1990s when private investors were first invited to trade on the Shanghai and Shenzhen stock exchanges for a limited proportion of shares upon IPO and how these restrictions were relaxed during the final stage of privatisation through the SSSR between 2005 and 2009. In addition, it highlights the other main structural reforms that combine with the SOE privatisation (i.e., the convergence of China's national standards with the IFRS and ISA).

The report also sheds light on the Chinese government's efforts to develop its domestic accounting industry to compete against the international Big 4 audit firms, by providing the domestic accounting firms with the needed financial and logistic support (e.g., providing training courses, facilitating foreign collaboration, and encouraging domestic firms to enter international memberships) and by imposing more restrictions on the international Big 4 audit firms (i.e., converting the international Big 4 joint ventures to special general partnerships that should follow strict regulations and abandon some ownership to the benefit of domestic audit firms). Finally, it raises the issue that mainland China consists of a number of different regions with different market development levels which, in turn, might affect the subsequent conjectures about the Chinese market as a whole.

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Appendices

Appendix A

Market development Index for the period 2003 to 2014

Province	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Anhui	5.37	5.99	6.73	7.29	7.73	7.64	7.88	7.89	8.24	8.07	8.32	9.17
Beijing	7.50	8.19	8.48	8.96	9.55	9.58	9.87	10.09	10.26	10.74	11.13	11.51
Chongqing	6.47	7.20	7.35	8.09	8.10	7.87	8.14	8.16	8.30	8.91	9.19	9.80
Fujian	7.97	8.33	8.94	9.17	9.45	8.78	9.02	8.81	9.02	9.45	9.62	10.25
Gansu	3.32	3.95	4.62	4.95	5.31	4.88	4.98	4.53	4.58	4.48	4.73	5.14
Guangdong	8.99	9.36	10.18	10.55	11.04	10.25	10.43	10.50	10.68	11.14	11.46	12.12
Guangxi Zhuang	5.00	5.42	6.04	6.12	6.37	6.20	6.17	5.64	5.83	6.72	6.87	7.04
Guizhou	3.67	4.17	4.80	5.22	5.57	5.56	5.56	4.68	4.76	5.49	5.65	5.98
Hainan	5.03	5.41	5.63	6.35	6.88	6.44	6.40	6.74	6.86	7.59	7.82	8.09
Hebei	5.59	6.05	6.61	6.93	7.11	7.16	7.27	6.64	6.87	7.15	7.34	7.76
Heilongjiang	4.45	5.05	5.69	5.93	6.27	6.07	6.11	6.00	6.18	7.17	7.36	7.38
Henan	4.89	5.64	6.73	7.07	7.42	7.78	8.04	8.06	8.21	8.35	8.54	8.87
Hubei	5.47	6.10	6.86	7.12	7.40	7.33	7.65	7.51	7.75	8.24	8.63	9.20
Hunan	5.03	6.11	6.75	6.98	7.19	7.18	7.39	7.43	7.68	7.67	7.81	8.73

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Inner-Mongolia	4.39	5.12	5.74	6.28	6.40	6.15	6.27	5.97	6.09	6.75	6.74	6.51
Jiangsu	7.97	8.63	9.35	9.80	10.55	10.58	11.54	11.66	12.26	13.03	12.96	12.71
Jiangxi	5.06	5.76	6.45	6.77	7.29	7.49	7.65	7.71	7.92	7.79	7.95	7.84
Jilin	4.69	5.49	6.06	6.44	6.93	6.99	7.09	6.69	6.84	7.35	7.43	7.62
Liaoning	6.60	7.37	7.92	8.18	8.66	8.31	8.76	8.38	8.46	8.67	8.72	9.02
Ningxia Hui	4.24	4.56	5.01	5.24	5.85	5.78	5.94	5.47	5.54	5.92	6.05	6.81
Qinghai	2.60	3.10	3.86	4.24	4.64	3.52	3.32	3.02	3.03	3.13	3.33	3.02
Shandong	6.81	7.52	8.44	8.42	8.81	8.77	8.93	6.45	6.55	6.74	6.93	6.93
Shanghai	9.36	9.81	10.25	10.79	11.71	10.42	10.96	8.71	8.86	9.25	9.39	9.77
Shaanxi	4.63	5.13	5.28	5.84	6.12	6.18	6.11	11.26	11.35	11.19	11.41	12.29
Shanxi	4.11	4.45	4.81	5.11	5.36	5.66	5.65	5.29	5.71	6.52	7.05	7.70
Sichuan	5.86	6.38	7.04	7.26	7.66	7.23	7.57	7.34	7.40	7.64	7.80	8.16
Tianjin	7.03	7.86	8.41	9.18	9.76	9.19	9.43	9.75	10.06	11.64	12.07	11.94
Tibet	0.79	1.55	2.64	2.89	4.25	1.36	0.38	3.02	3.03	3.13	3.33	3.02
Xinjiang Uygur	4.26	4.76	5.23	5.19	5.36	5.23	5.12	4.48	4.56	4.55	4.59	5.10
Yunnan	4.23	4.81	5.27	5.72	6.15	6.04	6.06	6.53	6.70	6.01	6.09	6.46
Zhejiang	9.10	9.77	10.22	10.80	11.39	11.16	11.80	11.78	11.93	12.88	12.99	13.33

Market Extracted from the National Economic Research Institute (NERI) periodic reports on Index of Marketisation of China's provinces 2003 to 2014.

Appendix B

CICPA Top-10 China audit firms for the period from 2003 to 2014

2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
PwC	PwC	PwC	PwC	PwC	PwC	PwC	PwC	PwC	PwC	PwC	PwC
KPMG	KPMG	KPMG	E & Y	E & Y	E & Y	E & Y	Deloitte	Deloitte	Deloitte	Deloitte	Deloitte
Deloitte	Deloitte	Deloitte	Deloitte	Deloitte	Deloitte	Deloitte	KPMG	KPMG	E & Y	Ruihua	Ruihua
E & Y	E & Y	E & Y	KPMG	KPMG	KPMG	KPMG	E & Y	E & Y	KPMG	E & Y	BDO

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BDO	BDO	BDO	BDO	BDO	RSM	RSM	RSM	RSM	BDO	BDO	E & Y
Jiangxi	Yue Hua	Shine Wing	Yue Hua	Ruihua	BDO	BDO	BDO	BDO	RSM	KPMG	KPMG
Rightson	Shine Wing	Asia-Pacific	Shine Wing	Shine Wing	Shine Wing	Wan Long	Shine Wing	Crowe Horwath	Pan-China	Daxin	Pan-China
Jingdu	Asia-Pacific	Yue Hua	Wan Long	Asia-Pacific	Daxin	Pan-China	Pan-China	Pan-China	Shine Wing	Pan-China	Da Hua
Shine Wing	Rightson	Rightson	Asia-Pacific	Rightson	Wan Long	Daxin	Crowe Horwath	Shine Wing	Crowe Horwath	Shine Wing	Shine Wing
Asia-Pacific	Jiangsu Notary	Jingdu	Rightson	Wan Long	Leanda	Shine Wing	Daxin	Daxin	Da Hua	Da Hua	Daxin

Big 10 audit firms based on The Chinese Institute of Certified Public Accountants (CICPA) Top-100 Accounting Firms annual reports. The CICPA rank the Top 100 on basis of their comprehensive evaluation scores (i.e. revenue, number of employed CPAs, internal governance, practice quality, human resource, global business, IT and social responsibilities of accounting firms.