

Impact of registration reform on small and medium-sized accounting firms

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Abstract: After the new securities law comes into force, the qualification of accounting firms to engage in securities audit business is changed from approval system to registration system. Against this background, as the first small and medium-sized accounting firm in China to undertake the annual audit of listed companies, Shenzhen Tangtang has attracted considerable attention. The article uses literature research and case studies to analyse the business share and development pattern of Shenzhen Tangtang before and after the reform of the registration system, and finds that Shenzhen Tangtang still has many shortcomings in undertaking securities audit business, but has successfully achieved the transition to scale. On the whole, developing securities audit business will do more good than harm to small and medium-sized accounting firms. Therefore, it is recommended that small and medium-sized accounting firms strengthen the construction of talent, enhance their own securities audit practice capacity, improve the level of information technology auditing, enhance sustainability and engage in securities audit business prudently.

1. Introduction

Accounting firms are independent third-party intermediaries, and some qualified firms undertake the work of auditing the annual reports of listed companies, reasonably ensuring the quality of accounting information disclosure of listed companies, providing decision-useful information for statement users, and always playing an important role in the capital market of China (Lu Guihua et al, 2020). It has always played an important role in China's capital market. However, not all accounting firms are qualified to audit listed companies. (Wu Xi et al, 2018, 2018) In October 1992, the Ministry of the Ministry of Finance began piloting the Socially Raised Companies Audit Qualification for shareholding pilot enterprises, which later evolved into the securities business Audit Qualification, setting thresholds in terms of age of establishment, number of full-time employees, work experience, income, and soon, dividing accounting firms into growing licensed and struggling unlicensed accounting firms. As well as the difficulty of developing unlicensed small and medium-sized accounting firms (Duan Hong, 2006), this has partly polarized the audit profession.

On March 1, 2020, the newly amended Securities Law came into force for the China's capital market in order to further promote the marketisation, legalization and internationalization of

our capital markets, further promote the reform and development of our capital market, and further develop the functions and role of the capital markets in serving the real economy. The revision of some of these laws has played a positive role in the fragmentation of accounting firms in China. For the first time, the new Regulations change the qualification of securities audit from an "approval system" to a "registration system." This means that market access restrictions for small and medium-sized accounting firms have been lifted, allowing them to engage in securities audit business.

Against this background, Shenzhen Tangtang Accounting firm (hereinafter referred to as "Shenzhen Tangtang") has become the first small and medium-sized accounting firm in China to publish audit reports of A-share listed companies, attracting wide attention. Since then, a number of small and medium-sized accounting firms have chosen to file for securities service, the development of securities audit business has become another development path for small and medium-sized accounting firms.

Although the implementation of the new Securities Law has given small and medium-sized accounting firms the opportunity to compete on a level playing field with large accounting firms in terms of securities audit business, small and medium-sized accounting firms still need to face greater disadvantages with large accounting firms in terms of capital, personnel, size, reputation and audit standards (Yang Shoukang, 2011). However, small and medium-sized accounting firms still need to face the disadvantages of large accounting firms in terms of capital, personnel, size, reputation and audit standards. In this context, is registration reform an opportunity for small and medium-sized accounting firms to grow and develop rapidly through their higher-margin securities audit business, or leading them to compete directly with large accounting firms when they are less powerful? Will this lead to direct competition with large accounting firms at a time when they are not as strong as they could be, which would not be worth the loss? After all, as "newcomers," small and medium-sized accounting firms have a huge learning cost in order to take on and complete lucrative securities audit engagements from the start (Chunfei Wu, Xi Wu, 2019) and take on relatively high business risks. (Xue Chao, 2016) New entrants to the securities audit business face significant learning costs and relatively high business risks.

Taking Shenzhen Tangtang Accounting firm as an example, this paper makes a survey and comparison on the development situation of Shenzhen Tangtang before and after the new securities law is implemented. It is found that while Shenzhen Tangtang still has a lot to improve, the reform of registration system has helped Shenzhen Tangtang to develop to scale, and the development of securities audit business has more advantages than disadvantages for small and medium-sized Accounting firms. At the same time, this paper puts forward three suggestions on the present situation and future development path of small and medium-sized accounting firms: strengthen talent training and improve their own practice capabilities; establish the information audit model to promote sustainable development; establish and improve the risk assessment and control department, and select the under writers of securities audit business carefully.

2. Literary Review

Compared with large accounting firms, the development situation of small and medium-sized accounting firms is more serious. Using the Porter's Five Forces model to analyse the survival environment of small and medium-sized accounting firms, it can be found that all five competitive forces of small and medium-sized accounting firms are at a disadvantage, with potential entrants and competitors within the industry being the main causes of this situation (Fan Lili, Liu Peipei, 2011). The poor environment for survival has led to a poor position for small and medium-sized accounting firms. The adverse environment leads to the following characteristics of small and medium-sized accounting firms: first, the number of small, competitive firms; second, the scope of

practice is single, the range of qualifications is narrow; third, the quality of practice is poor; fourth, the lack of human resources; and fifth, the internal governance mechanism is not sound. (Yuan Wenhua, Huo Hong,2008). The lack of material basis for investment in information technology, low investment and the limitations of human resources structure make it difficult for small and medium-sized accounting firms to keep up with technological advances and achieve the transformation of information technology construction(Zhu Hongzhu,2021) This is because of the low investment and human resources structure.

Of course, the smaller firm size also gives small and medium-sized accounting firms the advantages of efficient management, personalised services, small demand markets and low cost of doing business(Yang Shoukang,2011) The small size of a firm also gives it the advantage of efficient management, personalised services, a small demand market and low cost of doing business, and therefore allows it to differentiate itself by developing core talent, finding a market niche, choosing an appropriate profit model and developing core competencies. (Dai Qiong,2017) In addition, small and medium-sized accounting firms can differentiate themselves by cultivating core talent, identifying market niches, selecting appropriate profit models, and developing core competencies. In addition, SMEs can provide diversified non-audit services such as tax services, management advisory, personal financial planning, litigation support or help international SMEs achieve international growth in international taxation, compliance, foreign exchange and access to external finance. (Yanling Lin, Jicheng Liu, 2021) has a strong presence in international markets. With fewer individual resources, small and medium-sized accounting firms can join together through international accounting associations and networks to access more resources and promote healthy cooperation and competition among member firms to improve audit quality(Bills, et al.,2018; Bills, et al., 2020) However, China's weak institutional environment may overwhelm the quality control brought about by international accounting networks, resulting in membership having little or no impact on audit fees and quality(Mao, et al.,2017) This is not the case in China.

3. Case Presentation

3.1 Policy context

Compared with the old securities law, the new securities law has undergone significant changes and adjustments, the most notable of which is the transition from an "approved system" to a "a registered system": "Accounting firms should exercise due diligence to serve securities trading and related activities in accordance with relevant business rules. "To engage in other securities services, the the securities regulatory authority under the State Council and the relevant competent department the State Council shall be reported for the record. From the delegation of auditing powers from the state securities administration to stock stock exchange, to requiring intermediaries to exercise due diligence, the new securities law embodies the characteristics of "diluting administrative supervision and emphasizing market supervision". This also means higher requirements for the practice of accounting firms.

In addition to the "registration system" reform, the new securities law also makes amendments to information disclosure, investor protection, and the cost of violations. With regard information disclosure, the new securities law expands the concept of "information disclosure obligor" to include major shareholders, actual controllers and other relevant duty subjects, emphasizes the "timeliness, readability and friendliness" of information disclosure and improves the content of information disclosure requirements. The Opinion also emphasizes the "timeliness, readability and friendliness" of information information disclosure and improves the content of information disclosure requirements. In the area of investor protection, the new securities law adds a chapter on investor protection, which makes different provisions on the aggregation of voting rights and support for

“chinese-style” class actions, depending on the relationship between the investor and the issuer, intermediary and controlling shareholder. Securities compensation litigation System. In terms of the cost of violations, the new Securities Act significantly increases penalties for violations, increasing the maximum penalties for companies and those responsible tenfold or even tenfold. For example, for fraudulent issuers, a fine of up to RMB 20 million may be imposed if the securities have not yet been issued; if the securities have already been issued, a fine of not less than 10% and not more than 1 times the amount of funds illegally raised; and a fine of up to RMB 10 million may be imposed on the person in charge.

3.2 Shenzhen Tangtang Accounting Firm

Prior to the implementation of the new securities law, there were 12 employees in the Shenzhen Tangtang Accounting firm, of whom only 3 were certified public accountants. 2018 annual business income of Shenzhen Tangtang was RMB 853,200, including RMB 848,500 from audit business, net assets of RMB 120,000 and total assets of the company of RMB 680,000, ranking 215th in Shenzhen local. In recent years, the scope of operations covers capital verification, asset valuation, taxation services, etc.. The main sectors of service include manufacturing, information transmission, software and information technology services, wholesale and retail trade, transportation, warehousing and real estate.

During the audit of *ST Xinyi's 2019 annual report, the SSE expressed key concerns about it. between 26 March and 31 August 2020, the SSE issued a total of four questioning letters, asking detailed questions about the scale of Shenzhen Tangtang's business, its internal regulatory system, staff turnover and the qualifications, professional competence, relevant certificates and even the legality of the signature and recent whereabouts of the certified public accountant. The letter also asked in detail about the size of the operation, internal management system, staff turnover and CPA qualifications, professional competence, relevant certificates and even the legitimacy and recent whereabouts of signatures. Shenzhen Tangtang also responded positively, disclosing the relevant information while proving that it has the professional competence and independence to audit *STXinYi, and has taken out relevant insurance with a cumulative limit of RMB10 million and a limit of RMB2 million per claim, which can bear civil liability due to negligence in practice. As of the end of 2020, Shenzhen Tangtang also audited the 2020 annual reports of *ST Jinzhou, *ST Stix and five other listed companies.

4. Case studies

4.1 Before the implementation of the new Securities Act

As a typical small and medium-sized accounting firm, Shenzhen Tangtang also has the problems of low registered capital, low business manpower and scarcity of professional personnel. In recent years, along with the increasing revenue of accounting firm, Shenzhen Tangtang has faced many difficulties, such as passive adjustment of business scope, utilisation of talents, low cost caused by vicious competition, risk management and insufficient business expansion, which seriously restrict the development of the firm.

4.1.1 Low-end firms dominate

Due to the specific historical reasons for the development of China Audit market, large enterprises often have "specific qualifications" to control access to capital market and high-end business, such as auditing and consulting services for large conglomerates companies (Cheng Lu et

al., 2019; Fu Chao et al., 2020), and various special audits such as economic responsibility audits for government departments. (Wng Bing et al, 2009, 2009) Therefore, The Shenzhen Tangtang can only work without "specific qualifications". As a result, in areas that do not require "specific qualifications", Shenzhen Tangtang and television has to "fight", in the low-end of the business to compete fiercely with its peers.

4.1.2 Poor bargaining power

Unjustified low price competition has further weakened the viability and bargaining power of Shenzhen Tangtang. China's audit market is a fragmented and competitive market, with many competitors, a single line of business, low profit margins, excessive competition has become the main structural features of the market, and price competition has become the main competitive tools of enterprises. Thus, the more "bold" a firm is to offer low prices, the more likely it is to acquire business (New business(Cheng Yugui, 2015), which also creates the problem of "bad money driving out good money" and further squeezes the survival and development possibilities of highly professional and ethical firms and CPA teams. Although the industry has issued two documents in recent years, namely the "Tender Specification for Audit Engagements with Accountancy Firms" and the "Guidance for Accountancy Firms to Undertake Audit Engagements by Way of Tender", the results have not been significant. As long as this principle remains the same, it will be difficult to solve the problem of low price competition. The low level of excessive competition in the audit industry, especially the vicious competition in the middle and low end of the business, has led to the development of small and medium-sized firms, "bad money drives out good money", which in turn has aggravated the deterioration of the survival environment of Shenzhen Tangtang.

4.1.3 Difficulties in building a professional workforce

Talent is the number one productivity for accounting firms. However, due to low capital investment, poor reputation and inability to engage in high-end business, Shenzhen Tangtang is far less attractive to professionals than large firms, resulting in a fixed, homogenous staff structure and a lack of practical skills. At the same time, the firm is unable to provide challenging, growth-oriented work content and a superior work environment for its employees, which affects staff motivation, creates a brain drain, and leaves employees with outdated and rigid knowledge, which makes it difficult to build a professional team that keeps pace with the times.

4.1.4 Lack of sustainability

With the popularization and development of digital and intelligent methods such as commercial robots and auditing platforms in auditing field, the auditing industry will change greatly in the foreseeable future. Low-end agency bookkeeping services, as well as basic tax issues and business training, will be replaced by low-cost and standardised services, and many financial tax issues will not even require accountants. Therefore, Shenzhen Tangtang, which is mainly engaged in traditional agency bookkeeping and accounting audit services, faces severe challenges.

Due to the relatively small number of employees in Shenzhen Tangtang, the structure is single, the new business capabilities is not developed enough to adapt to the rapidly changing market demand of the industry. On the other hand, with the rapid development of new technologies such as internet, big data, cloud computing and artificial intelligence, traditional businesses such as financial Q & A, agent tax declaration and agency bookkeeping will be gradually replaced by AI. The total market demand will be seriously affected and competitive pressure will be further intensified in Shenzhen Tangtang, which has no core technology.

4.2 After the implementation of the new Securities Law.

The implementation of the new securities law has eased the qualification of securities auditors, allowing small and medium-sized accounting firms to take the annual audit of listed companies and compete fairly with large accounting firms in the audit market. However, the "hardware and software" disadvantages of small and medium-sized accounting firms has not disappeared, and listed companies prefer to hire large accounting firms with good brands, resources and business familiarity. Faced with this situation, Shenzhen Tangtang chose to enter the audit market to audit the annual reports of ST listed companies with higher risk to achieve scale development, but this also led to problems such as the firm's reputation damage.

4.2.1 Focused ST's business

There are 4,547 listed companies in China, of which 3,167 are listed on the Main Board, 1,038 are listed on the venture board and 342 are the Science and Technology Innovation Board, with annual audit fees amounting to tens of billions of yuan. In the past, the annual audit fees of all listed companies were shared by 40 securities firms, but now that access has been relaxed, other small and medium-sized firms are eager to take advantage of the huge slice of the pie. And Shenzhen Tangtang, a small accounting firm, earned only \$853,200 for a full year in 2018. Faced with a large audit market and high audit fees, Shenzhen Tangtang naturally hopes to gain some revenue as soon as possible in order to smoothly enter the annual audit market of listed companies.

In March, the new securities law came into effect, and most publicly traded companies have identified auditors for their 2019 annual reports. The rest are mostly on the fence about the changes, with few truly viable options. Among the limited options available, ST companies with not insignificant problems, financial or otherwise, make up the majority. Whether there are problems of capital appropriation, irregular guarantees, doubtful going concern, poor asset quality, etc., this will undoubtedly increase the risk and cost of annual audit, make accounting firms more inclined to audit non-ST listed companies, and also put ST companies at a disadvantage in the face of accounting firms, willing to pay higher audit fees to seek better audit opinion. Under such circumstances, Shenzhen Tangtang's focus on undertaking the business of ST-listed companies not only solves the immediate needs of ST-listed companies, but also takes the opportunity to smoothly develop the securities audit business, which is the optimal solution for both of the under certain circumstances.

4.2.2 Inadequate practice skills

The purpose of the new securities law is to deepen the reform of "management service" in accounting firms, strengthen healthy competition among firms through marketization, and promote the high-quality development of the industry. The audit of *ST Xinyi by Shenzhen Tangtang was a combination of a small firm with insufficient capacity and a problematic company, which defied the original intent of the new Securities Law and the regulator and led to prudent supervision by the regulator. The Ministry of Finance issued the Quality Evaluation and Classification Measures for Public Accountants' Firms (draft opinions), which stratified accounting firms, arguing that small and medium-sized accounting firms with low ratings should not engage in securities audit business. The SSE even sent four letters of inquiry questioning their professional competence and their ability to provide civil compensation on time during the audit of Shenzhen Tangtang's annual report. Under the heavy supervision of the SSE, Shenzhen Tangtang's inexperience of entrepreneurial experience was first exposed. In the process of undertaking the audit of *ST Xinyi, Shenzhen Tangtang changed its CPA four times, and was exposed to a series of farces such as the firm's official seal being out of control, and the preliminary engagement letter and response announcement not being

the true intention of the CPA concerned, all of which showed that there were serious problems with Shenzhen Tangtang's internal decision-making mechanism and control situation, and that it was very reluctant to audit the annual reports of listed companies. The matter remained open after the release of the annual report. On February 19, 2021, the SFC formally opened a case against Shenzhen Tangtang for alleged audit work irregularities. Subsequently, *ST Hemi and *ST Netforce, which had already disclosed that they had re-appointed Shenzhen Tangtang as the company's auditor for 2020, cancelled the motion to engage Shenzhen Tangtang.

4.2.3 Branding difficulties

Audit market is a typical information asymmetry market, and the existence of brand and reputation mechanisms can provide an incentive for accounting firms to provide high-quality audit reports at a premium. After the events of *ST Xinyi, Shenzhen Tangtang also undertook the annual audit projects of ST listed companies such as *ST Jinzhou, *ST Steamboat, *ST NetForce, *ST Hemi, etc., and "ST Audit Speciality" became a distinct label of Shenzhen Tangtang Tang, to the detriment of its branding and reputation. This is not conducive to Shenzhen Tangtang brand building and reputation enhancement.

A well-known firm brand as well as a good firm reputation needs to be established through the enhancement of service capabilities and service quality. To this end, accounting firms need to broaden the scope of their services so that they can meet the various professional requirements of domestic and foreign clients in the Audit market. The specialisation of the project by the listed company of science and technology creates no doubt compresses the service scope of Shenzhen Tangtang film and television, which inevitably excludes the business needs of other listed companies and is not conducive to the branding and business scale expansion of Shenzhen Tangtang film and television after that.

At the same time, according to the incomplete contract theory, due to the uncertainty of the future and the asymmetry of information, it is impossible for the contracting parties to conclude a complete contract without specifying all terms in advance. The incomplete nature of the contract would therefore lead to the possibility of haggling ex post facto. Specifically, when accounting firms rely on audit client to realize their economic value, it is easy to have the problem of moral hazard after the fact, which weakens the auditor's independence and reduces the quality of their audit. In the case of Shenzhen Tangtang, it is inevitable that market participants believe that ST bought audit opinion through high audit fees, which also strengthens Shenzhen Tang's dependence on customers, thus reducing the quality of service and affecting the firm's reputation.

4.2.4 Significant growth in revenue and size

Even though it received many questions and had a lot of problems when practicing, Shenzhen Tangtang's firm revenue and size still saw significant growth. Shenzhen Tangtang's revenue \$4,995,300 in 2020, of which \$4,584,200 was from securities audit, an increase of nearly 13 times from audit business revenue of 2019. Following *ST Xinyi's decision to retain Shenzhen Tangtang as the auditor of the Company's 2020 Annual Report, Shenzhen Tangtang assumed the responsibility of auditing the 2020 Annual Report of *ST Jinzhou, *ST Steamboat and 11 other publicly traded companies, all of which have successfully published audit business annual reports and established themselves in the securities audit market. As at 21 January 2021, the number of practitioners in Shenzhen Tangtang has increased to 55, including 4 partners, 13 certified public accountants and 7 certified public accountants who have engaged in securities services, with a large number of additional professional talents and a significant growth in the firm's scale.

To sum up, while Shenzhen Tangtang Accounting Office has not reached the initial stage where

it can successfully undertake the audit of listed companies' annual reports, it has also seized the opportunity to the firm's take-off in terms of scale, business, team and revenue, and in December 2020 joined the top 100 accounting firms in Shenzhen.

4.3 Comparison before and after the implementation of the new Securities Law

In recent decades, the securities audit qualification, like the cracks between the 40 large accounting firms and other small and medium-sized accounting firms, has also increased the concentration of the audit industry, with small and medium-sized accounting firms, including Tang Tang in Shenzhen, facing increasing competitive pressure. In addition, the predominance low-end enterprises, poor bargaining power, difficulties in building a professional workforce and lack of sustainability also constrain the development of enterprises. The reform of the registration system of the new Securities Law has brought a new development direction to Tangtang, Shenzhen. Wider securities market, higher audit fees, and *ST's new material requirements for sound audit opinions make Shenzhen Tangtang the first firm to jump on the transformation bandwagon.

Although Shenzhen Tangtang's attempt to develop its securities audit business did not yield a perfect answer in terms of process and outcome, the *ST Xinyi audit event undoubtedly sent a positive signal, not only allowing Shenzhen Tangtang to grow significantly in revenue, size and number of employees, but also giving other small and medium-sized accounting firms confidence to enter the securities audit market. As of the end of April 2021, 69 small and medium accounting firms had applied for securities services, and a total of four small and medium accounting firms had undertaken the audit of the 2020 annual reports of nine listed companies, according to the Securities Audit Market Analysis Report 2020 issued by the China accounting firms Association. These changes undoubtedly indicate that entering the securities audit market is a feasible development path for small and medium-sized accounting firms.

5. Conclusions and Recommendations

After nearly two years of efforts, the new securities law has begun to bear fruit, with a significant increase in the number of listed enterprises and accelerated expansion of the securities market, creating a larger market and greater opportunities for the securities audit industry. At the same time, a number of small and medium-sized accounting firms represented by Tang Tang Tang in Shenzhen have also made great progress. Although the annual audit task is onerous and demands more from the firm, the rich rewards also accelerate the progress of small and medium-sized accounting firms in terms of team size, quality of practice and capital investment.

In order to create a standard and orderly capital market regulatory environment under the new policy background and help small and medium-sized accounting firms develop better, the following suggestions are put forward:

First, we should strengthen the cultivation of talents and improve our own practice capabilities. The amendment of the new securities law has relaxed the entry conditions of the securities audit market, marketized the previously closed business and brought development opportunities for small and medium-sized accounting firms, while also putting forward higher requirements for the practicing ability of small and medium-sized accounting firms. In a competitive market, small and medium-sized accounting firms do not have an advantage over large accounting firms, but are disadvantaged by lack of experience and resources. Therefore, while doing a good job of building their own brand, small and medium-sized accounting firms should actively expand their securities audit business, adopt simulated practical learning, situation teaching, online platform teaching, and so on, do a good job of continuing education for practitioners, ensure the renewal of their professional knowledge and professional ethics, and improve the independence of certified public

accountants. At the same time, emphasis will be placed on the introduction of legal, engineering, computer and other non-accounting and auditing professionals, the scientific staffing of audit teams, the improvement of their own practice capabilities and the quality of audit reports issued, to gain sufficient market competitiveness and market reputation.

The second is to establish an information audit model to enhance the capacity for sustainable development. With the support of computer technology, audit business form will change significantly. The audit efficiency is more and more high and their plasticity is more and more strong. Small and medium-sized accounting firms should actively respond to the requirements of the market, do a good job of transformation and upgrading, actively apply computer technology, better provide audit services to customers, and support the firm's development strategy. At the same time, small and medium-sized accounting firms should give full use of their greater flexibility in the course of business operations, apply information technology and intelligent technology in the course of business operations, realize the process and standardization of audit work, ultimately reduce the cost of audit work, improve the firm's ability to adapt to the environment, and ultimately enhance the firm's sustainable development.

Third, we should conduct a prudent securities audit business. The new Securities Law does more than lower the threshold for securities audit business; it also provides for enhanced legal liability for accounting firms, making them subject to increased penalties following breaches of the law. Five of the nine listings that New Three Plates handled in 2020 had varying degrees of problems and were subject to delisting or other risk warnings. Dedicating audit work to high-risk firms is a ground-breaking option for small and medium-sized accounting firms, but it is clear that increasing audit risk in this way is not a long-term solution. Therefore, small and medium-sized accounting firms should not focus on short-term interests and engage in random audits. On the contrary, a listed company should be fully informed, should remain independent of third parties, should not meet unreasonable requirements of listed company due to excessive audit fees, and, after a full assessment and weighing of risks, should carefully decide whether to conduct business in order to ensure the overall risk and long-term development of the firm.

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