

An Analysis of Administrative Penalty against Accounting Firm and CPA-- Based on the CSRC's Bulletins from 2001 to 2016

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Abstract. This paper analyzed the punishment bulletins released by CSRC against accounting firms and CPAs from 2001 to 2016. We use statistical manners to demonstrate the different types, reasons, penalty speed and penalty intensity of those cases. Chinese administrative penalty has its own characteristics and changed with time. Authorities should increase penalty intensity and accelerate penalty speed to strengthen regulatory on the accounting firms and CPAs in the future. Last but not least, the firm mergers caused by penalty also deserves the attention of regulators.

Keywords: Administrative penalties, Accounting Firm, CPA, CSRC

1 Introduction

As a service providing credibility, auditing itself is subject to supervision by many parties. The supervisors of the audit activities mainly includes the Ministry of Finance, CICPA, National Audit Office and CSRC. All of them use professional standards, laws and regulations to regulate the audit activities. Many Chinese audit professional standards, laws and regulations have provided the standard of the audit quality. For example, the "Diligent and Responsible" rule in the *Securities law* provides a good summary. CSRC, one of the most important supervisors of Chinese audit market, measuring the quality of the audit activities in a process-oriented manner. Every year CSRC will hear the law cases, and illegal accounting firms and certified public accountants will be subject to sanctions. Some scholars have investigated the punishments' impact on auditors' behaviors from the perspective of customer's discretionary accrual and the auditor's tendency to issue non-standard opinions [1, 2].

However, what are the characteristics of CSRC's administrative penalty? What are the consequences for the accounting firms and auditors who subject to sanctions? At present, only several literatures made comprehensive analysis of this topic. Therefore, this paper made a further study based on hundreds of administrative penalty bulletins from 2001 to 2016.

2 Statistical Analysis

2.1 Sample Selection and Data Sources

This paper selects the administrative penalty bulletins against accounting firms and certified public accountants from 2001 to 2016 as research samples. The research data are collected manually from the website of CSRC. From 2001 to 2016, CSRC imposed a total of 56 penalty cases against accounting firms and certified public accountants. In this paper, those 56 cases were described by in the following tables and figures. In addition, we will demonstrate you the causes, types, speed and consequences of CSRC administrative penalties.

2.2 Penalty Reason

For the penalty reason, the largest number of cases mentioned revenue or profits inflation. Green-Land Biological Technology inflated income in its 2007 and 2008 financial statements, resulting harsh social impact in stock market. In the end, its auditor -- Shenzhen Pengcheng accounting firm was revoked the qualifications of the securities. Moreover, its chief CPA Yao Guoyong and Liao Fushu were sentenced to lifelong market ban. Green-land case is the most severe punishment made by CSRC up to now. Besides, there are some cases involved collusion between clients and auditors. For example, in 2008, Poly Real Estate bribed the management staff of Lixin

accounting firm-- Zhang Songqing. Finally, Zhang Songqing was sentenced to a fine of 220,000 yuan. The Lixin firm was not penalized. In 2006, Jinli Technology faces delisting, its auditor Wanlong firm use "avoid customer delisting" as their auditing purpose. The final penalty was 1 million yuan, four certified public accountants were also subject to different degrees of punishment.

Table 1 Main Penalty Reasons and Representatives

Main Types of Penalty Reason	Typical representative	Number
Profit or Sales Inflation	Green-Land, Yukaifa, Zhengzhou Baiwen	14
Assets Inflation	Beiya Industrial, Jingmi Shares	3
Collective fraud	Sinovel Power, Poly Real Estate	6
IPO Negligence	Xintai Electrical Appliances, Wanfu Biotechnology	7
Unidentified Related Party Transactions	Beisheng Pharmacy, Demian Shares	8
Others	Fengle Seed Company, Guilin Jiqi	18

2.3 Penalty Speed and Penalty Intensity

As a regulatory authority, CSRC plays an irreplaceable role in the correction of Chinese security market's irregularities. We have carried out a statistical analysis on the handling speed and the penalty intensity of the administrative penalty cases against accounting firms and certified public accountants during the past 16 years. We use Stata 14.0 to draw the following Fig.1. From the Fig.1, we found that in the past 2016 years, CSRC penalized four cases against accounting firm and CPA, the average amount of fines up to 5.30 million yuan each case. And in 2001, the average amount of the fines is only 0.34 million yuan each case. We can see from the figure 1 that, the CSRC's fines amount in recent years increased steadily, especially after 2011, growth rapidly. The increase in the penalty intensity means that the cost of illegal behavior increased, which will play a stronger role in warning accounting firms and CPAs.

Although some literatures had investigated the penalty intensity [3, 4], the current literature did not take the speed of CSRC punishment into account. We have reason to believe that the "fast and ruthless" punishment is more useful than the "slow and ruthless" punishment. Therefore, we set the variable *speed* to measure the CSRC's penalty speed. In the Green-land case, the disclosure year is 2013, the omission year is 2007 and 2008. So the speed of Green-land case is 6 years.

$$\text{Speed} = \text{Disclosure year} - \min(\text{Omission year}). \quad (1)$$

However, our statistical results show that during the past 16 years, the punishment speed of CSRC against accounting firms and certified public accountants is oscillating. In the following chart, there is no continuously upward or downward trend. How to accelerate the speed of punishment and penalize criminals as soon as possible, is the CSRC's urgent issues.

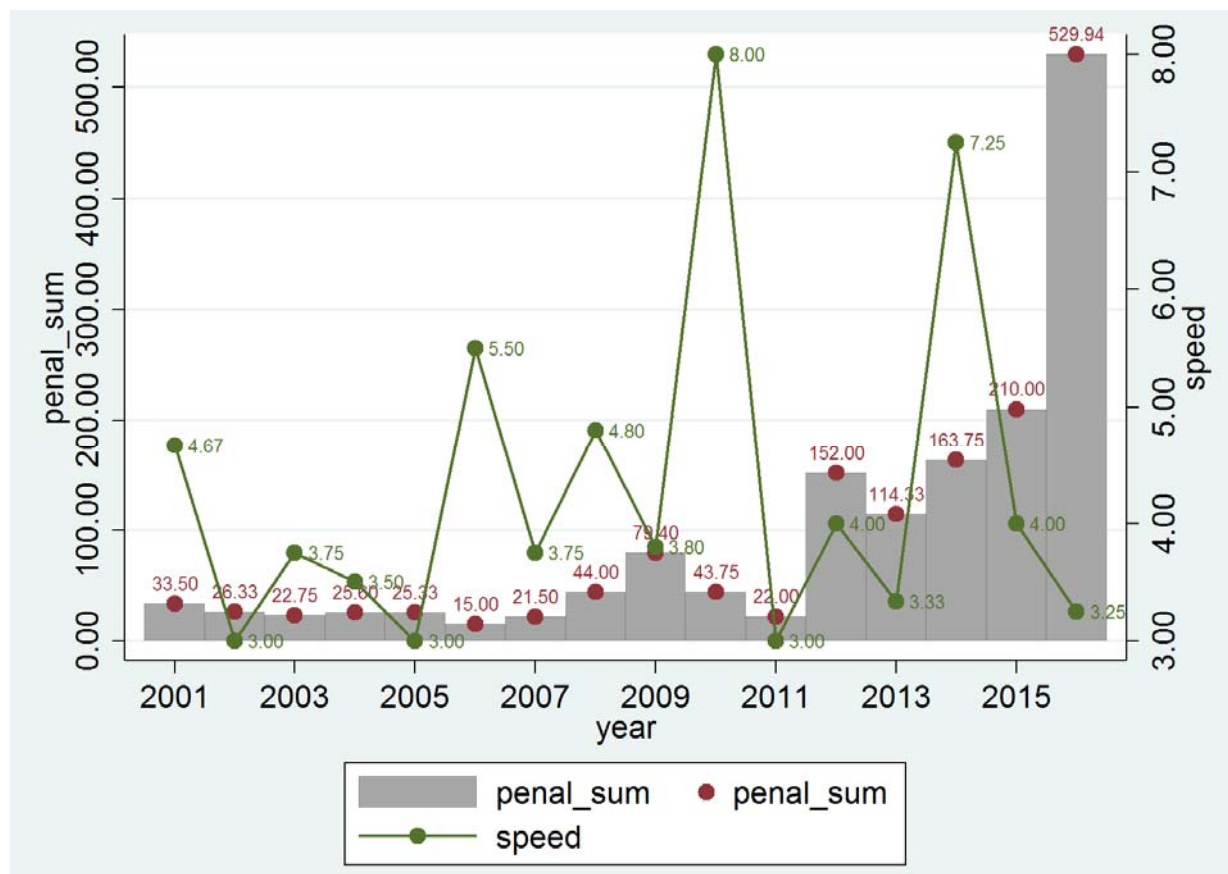


Figure 1. Average Speed and Intensity of Each Year

2.4 Penalty Types

As we can see from the table 2 below, CSRC's penalty types against accounting firms mainly includes fines, warning plus a fine, ordered to correct plus a fine. In recent years, usage frequency of ordered to correct plus a fine significantly increased. Among the cases, two accounting firms were revoked of the securities qualification in 2013. They were Zhongleifirm, which audited WanfuBiotechnology, and Shenzhen Pengcheng firm, which audited Green-Land.

Table 2 Penalty Types against Accounting Firms

Year	Warning	Fine	Warning plus fine	Ordered to correct plus fine	Revoke CSRCurity Qualification
2001			2		
2002	1	1	1		
2003		3			
2004	1	1	2		
2005		1	1		
2006		1			
2007	1	1	2		
2008		1	2	1	
2009		3	1	1	

Table 2, cont

2010			2		
2011					
2012				1	
2013		3		1	2
2014	1	2	1		
2015				1	
2016		2		2	
Sum	4	19	14	7	2

At the same time, the CSRC's punishment against CPA mainly includes fines, warnings and warnings plus a fines. In recent years, a new form emerged. The usage frequency of market forbiddensignificantly increased. In many cases after 2013, market bans are used in conjunction with warnings and fines. This also shows that punishment intensity against CPA has gradually increased.

Table 3Penalty Types against CPAs

Year	Warning	Fine	Warning plus fine	Market forbidden plus fine	Market forbidden, warningplus fine
2001	6	3		8	
2002	2	5			
2003	2	2	3		1
2004	7	5			
2005	1	6			
2006	2	2			
2007	4	4			
2008		7	4		
2009	1	4	7		1
2010		3	2		
2011		1			
2012			4		
2013					8
2014	3	6	1		2
2015					2
2016			6		3
Sum	28	48	27	8	17

2.5 Firm Merger

In the Green-land IPO scandal in 2012, Shenzhen Pengcheng firm was involved in that case. Soon after, Pengcheng firm announced its merger with GuofuHaohua firm without any penalties from the regulatory authorities. Feng Hongmei (2014) said that firm merger can truly repair the reputation of auditors [5]. In the Pengcheng case, the reasons of merger were questioned by outside world, but also aroused the strong voice that accounting firms should be investigated and penalized seriously. The following table 4 shows us several mergers in the recent years related to CSRC penalty.

Table 4 Mergers Related to Penalty

Firm Name	Year of Punishment	Cases	Merger
Shenzhen Pengcheng Firm	2013	Green-land	Merged into GuofuHaohua Firm in 2012
Zhonglei Firm	2013	Wanfu Biology	Divided into Daxin, Reanda, Huafuhua in 2013
Wanlong Firm	2009	Jinli Tech	Merged into GuofuHaohua Firm in 2009
Mindu Firm	2009	Tianxiang Group	Merged into Lixin Firm in 2007
Zhengyuan Firm	2008	Jiufa Shares	Merged into Zhengyuan Hexin Firm in 2000

3 Recommendations to the Authorities

In order to reduce the illegal acts of accounting firms and certified public accountants and promote the healthy development of CPA industry, authorities need to further strengthen supervisions from the following aspects. Firstly, strengthening the real-time monitoring of CPA behavior, reduce the detention of supervision and punishment. Secondly, increasing the penalties intensity for the CPA violations and playing a stronger role in warning accounting firms and CPAs. Last but not least, because of merger, many firms avoided to be penalized. However, it resulted in some large local accounting firm's poor governance and potential crisis.

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