

Research on Compliance Challenges and Countermeasures of Chinese Small Accounting Firms

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Abstract: *With the increasing scrutiny of accounting firms by regulators, the compliance of accounting firms has been paid more and more attention. By combining the regulatory environment of Chinese accounting firms and the characteristics of small accounting firms, this paper explores the compliance challenges that Chinese small accounting firms generally face and some compliance measures that can be taken, so as to provide certain references for the compliance operation of Chinese small accounting firms.*

Keywords: *Chinese small accounting firms, regulatory environment, compliance challenges, compliance measures*

1. Introduction

With the continuous improvement and internationalization of Chinese accounting regulations, and considering the complex regulatory environment, accounting firms need to strengthen compliance management to enhance the firm's governance level and ensure the quality of its audit and consulting services. For some small accounting firms, there are limited human and financial resources to fully meet regulatory requirements, so there are some compliance challenges. This article explores some of the common compliance challenges faced by small accounting firms in China and how to deal with existing and potential compliance challenges in a complex regulatory environment to help small accounting firms operate in compliance with relevant laws and regulations in China and maintain compliance in a rapidly changing regulatory environment.

This article first introduces the regulatory environment of Chinese accounting firms. Then, combined with the characteristics of small accounting firms in China, it analyzes in detail the compliance challenges and risks that small accounting firms may have in such a regulatory environment, and how to deal with these compliance challenges and risks. The purpose is to enable small accounting firms to deal with compliance challenges and reduce compliance risks in the short term by implementing a series of targeted strategies and measures, and to establish a complete compliance management system in the long term.

2. Regulatory Environment

For accounting firms, understanding the firm's regulatory environment is fundamental to compliance development. The regulatory framework for accounting firms in China involves several key players, each with specific roles and responsibilities in overseeing the accounting profession. The main regulatory bodies are:

2.1. Ministry of Finance (MOF) and local finance departments

The MOF is the primary regulatory body for accounting and auditing in China. It sets accounting standards, auditing standards, and ethics for accountants. It is responsible for formulating and issuing accounting regulations, policies, and guidelines. It oversees the implementation of these standards and ensures compliance across the industry.

2.2. Chinese Institute of Certified Public Accountants (CICPA) and local associations of certified public accountants

The CICPA is a self-regulatory organization for the accounting profession in China, operating under the guidance of the MOF. It administers the CPA examination, provides professional training and

continuing education, develops and enforces professional standards, and conducts disciplinary actions for professional misconduct.

2.3. China Securities Regulatory Commission (CSRC)

The CSRC is the regulatory authority for the securities market in China, and it oversees the work of accounting firms that audit publicly listed companies. It sets specific auditing requirements for listed companies, monitors the quality of audits, and ensures the transparency and reliability of financial reporting in the securities market. The CSRC can impose sanctions and fines on accounting firms and auditors for violations related to securities laws and regulations.

Regulators mainly enforce regulation through a combination of supervision, inspection, and disciplinary actions.

Monitoring Inspections: The MOF and CSRC conduct regular and special inspections of accounting firms to ensure compliance with accounting and auditing standards. These inspections can be triggered by routine checks or specific concerns about a firm's practices.

Disciplinary Actions: The CICPA has the authority to take disciplinary actions against CPAs and accounting firms for professional misconduct, which can include fines, suspension, or revocation of licenses. The MOF and CSRC also have the power to impose penalties for non-compliance with regulatory standards.

Legal Measures: In cases of severe violations, legal action can be taken against accounting firms and individuals, including criminal prosecution for fraud or gross negligence.

The regulatory framework is designed to ensure high standards of practice, protect investors, and maintain the integrity of financial reporting and auditing processes. The combined efforts of these regulatory bodies help create a robust and accountable accounting profession in China.

3. Compliance Challenges

From the perspective of the regulatory environment for accounting firms, many regulatory requirements for accounting firms are mainly to ensure transparency, integrity and professionalism within the industry. However, some of these requirements can create challenges and inconvenience for small accounting firms with limited resources. The following explores a few compliance challenges that may be common to small accounting firms.

3.1. Inadequate Organizational and Regulations

Small accounting firms generally lack an independent compliance department and has not developed a dedicated "Compliance Management System". The internal control and management mechanisms are inadequate, and employees lack compliance awareness, which makes it difficult to effectively monitor and manage compliance risks. Inadequate internal controls can lead to compliance gaps and operational risks.

While small accounting firms have internal quality control systems, they often lack the resources to implement and maintain the high-quality control system required by the CICPA.

The internal rules and regulations of small accounting firms may not be as well established as regulators require.

3.2. Inadequate adaptability to changes in the regulatory environment

As the regulatory environment continues to change, on the one hand, accounting firms need to quickly adapt to new regulations and guidelines. For example, with the continuous update of accounting and auditing regulations in China, accounting firms need to constantly adjust their business processes and compliance measures to meet new requirements, while small accounting firms may not have the flexibility and rapid response ability to respond to changes, which can lead to compliance risks and regulatory penalties. On the other hand, the increasing regulation requires accounting firms to ensure that their business operations and record keeping comply with regulatory requirements, which is a greater challenge for small accounting firms.

3.3. High IT Requirements and High Security Standards

Multiple laws and regulations, as well as industry standards, require accounting firms to adopt advanced information technology systems and security measures to ensure the security of client data and improve work efficiency. Article 10 of the “Data Security Law of the People's Republic of China” clearly point out that relevant industry associations and members should ensure data security in accordance with the law, strengthen industry self-discipline, and promote the healthy development of the industry (THE NATIONAL PEOPLE'S CONGRESS OF THE PEOPLE'S REPUBLIC OF CHINA, 2021).^[1]

However, small accounting firms may lack sufficient funds to invest in expensive information technology infrastructure and security systems. On the one hand, small accounting firms have small income scale and little accumulation, which cannot guarantee the continuous investment in informatization. On the other hand, small accounting firms lack IT talents, and the current business structure and nature of small firms are not very dependent on IT, so the internal motivation to introduce IT talents is insufficient. Therefore, the cost of independent implementation of information technology by small accounting firms is high, and the implementability is insufficient.

At the same time, due to the defects of informatization, small accounting firms still have the risk of information leakage. To ensure compliance with data protection laws, the cost of maintaining the security of customer data is relatively high. In addition, the lack of information technology support, work efficiency is also relatively low.

3.4. Compliance Requirements for Cross-Border Business

Small accounting firms face higher compliance difficulties and costs when dealing with cross-border business, while also being aware of the risk of compliance lapses and degraded service quality. For small accounting firms engaged in cross-border business, there are several domestic and international regulations and regulatory requirements that must be complied with. However, companies often lack experience and resources in cross-border compliance, and lack sufficient cross-border service professionals and training resources to ensure that employees have the expertise and skills to deal with complex international regulations and standards.

3.5. Multilayered Regulatory Reporting Requirements

Accounting firms are required to regularly submit reports and data to the various regulatory bodies mentioned earlier. Small accounting firms often lack sufficient staff to handle frequent and complex reporting needs, resulting in excessive compliance workloads.

4. Compliance Measures

This part studies the root causes of compliance challenges, and draws on better compliance methods abroad to propose the following compliance measures. They can be widely used to response the compliance challenges faced by small accounting firms, including the common compliance challenges mentioned above and others not mentioned.

4.1. Improve Internal Rules and Procedures

Firms can revise and update existing internal policies and procedures according to the latest laws, regulations, and industry standards, and ensure that all employees are aware of and implement new policies. They can designate a person to follow the latest policies and laws and regulations in real time.

Firms can formulate compliance system, clarify compliance standards and requirements, helping employees know clearly what compliance behavior is and what is non-compliance behavior.

4.2. Foster a Compliance Culture

4.2.1. Strengthen Training and Education

Firms can organize regular compliance training and education to help employees understand the importance of compliance, enhancing their compliance awareness and legal knowledge.

Firms can conduct intensive training, such as anti-money laundering and new accounting standards,

and conduct training assessments to improve employees' understanding of new regulations and internal policies.

Firms can also strengthen the practice of professional ethics, foster a strong ethical culture within the firm, and provide training on professional ethics guidelines and conflict of interest policies.

4.2.2. Compliance Publicity and Exemplary Role of Leadership

Firms can carry out compliance publicity activities through internal publicity, websites, WeChat public accounts and other channels to let employees understand the importance and significance of compliance.

The leadership should establish an unshakable awareness of compliance, consciously comply with compliance requirements, and play an exemplary role in guiding employees to comply with compliance requirements.

4.2.3. Establish a Compliance Culture Evaluation System

- **Establish a Compliance Culture Evaluation System**

Firms can evaluate and assess employees' compliance behaviors to promote adherence to compliance requirements. Simultaneously, create a compliance reward mechanism to incentivize employees who comply with regulations and penalize those who violate them. This will encourage employees to consciously follow compliance standards.

- **Regularly Assess and Improve Compliance Culture**

Firms can conduct periodic evaluations of the compliance culture and make necessary improvements to enhance its scientific and effectiveness. Report evaluation results to the chief partner and department managers to facilitate timely adjustments and enhancements to the compliance culture.

- **Establish a Compliance Reporting Mechanism**

Firms can encourage employees to report non-compliant behaviors to prevent internal violations within the firm.

4.3. Internal Collaborative Self-assessment method ^[2]

In *Compliance and Control 2.0* published by McKinsey in 2012, a new way of thinking about regulation and quality control is proposed, which is to take a fresh look at regulation and quality control as an opportunity to drive change and promote excellence, ultimately achieve sustainable competitive advantage, and for firms to benefit from full regulation, it is crucial to capture this spirit and not merely get lost in the regulatory text (Alberth et al., 2012).

Alberth et al. (2012) believed that making compliance and quality control effective requires clear strategic considerations, and the final goal is that compliance and control are not only effective, but also efficient and intelligent, and it can finally add strategic value. To avoid falling into the trap of blind compliance and instead focus on turning the regulatory storm into an opportunity to create competitive advantage, firms need a systematic, somewhat innovative, and disciplined approach known as internal collaborative self-assessment. This approach supports corporate compliance improvement plans and redirects energy and resources wasted on blind compliance and controls to tangible improvement and excellence.

Initially, it entails creating transparency levels across the firm, allowing simultaneous evaluations of compliance and quality in all relevant areas, fostering deep involvement from relevant domains within the firm. Specifically, this involves decentralized, thorough, and rigorous self-assessment by management, with independent validation of results. Individual managers often know their areas best, and they are best equipped to make assessments, so quality deficiencies and noncompliance can be detected more reliably and effectively. This puts the responsibility for effective compliance and quality control directly in the hands of these managers. And because the results are independently verified, there is a strong enough incentive for management to apply an appropriate level of candor and effort to rigorous self-assessment. Of course, it helps to perform self-assessments in a culture that is not afraid of mistakes. If firms find this challenging, counterincentives can be implemented where disclosing discrepancies in self-assessment is seen as a positive contribution to excellence, while later discovery is viewed as conscious deception. This rigorous and thorough self-assessment method aids in strengthening best practices (Alberth et al., 2012).

Subsequently, during the implementation phase, discussions around corporate governance and deficiencies in risk culture should be held, and action plans formulated to address them, thus bringing any systemic issues to the surface. As those identifying gaps in their areas of responsibility can help determine and implement solutions, this approach ensures maximum support for potential action plans. Finally, documenting the results of the self-assessment can be an excellent starting point for external supervision. In short, the emphasis is on addressing the root causes of systemic flaws, failures, and quality issues by focusing on best practices aligned with regulatory needs. This gives management the opportunity to internalize the regulatory process because management is basically in the shoes of the regulator and thus fundamentally changes their view of the regulatory process (Alberth et al., 2012).

This internal collaborative self-assessment method demonstrates a proactive management approach that can enhance the effectiveness and efficiency of internal oversight, significantly reducing the time and effort required to address external regulatory demands and freeing up resources for other operational activities (Alberth et al., 2012).

4.4. Strengthen External Ties

Small accounting firms can ease the burden by strengthening external contacts.

4.4.1. Joint Resource

Firms can collaborate with other accounting firms to share resources and expertise, reducing compliance costs.

4.4.2. Technology Application

Firms can utilize cloud computing and other advanced technologies to reduce IT infrastructure investments and enhance work efficiency. For example, they can leverage advanced accounting software and tools to streamline processes, ensure accuracy, and maintain compliance.

4.4.3. Regulatory Communication

Through existing communication platforms or actively building discussion platforms, as well as actively participating in industry association events, firms can maintain good communication with regulatory agencies and industry associations, stay informed about regulatory changes, and seek guidance and support.

On one hand, firms can reflect the difficulties faced as a small accounting firm to regulatory authorities and strive for more flexible policies and support. On the other hand, firms can engage in proactive stakeholder management with industry associations, regulatory authorities, and regulators to strategically shape requirements, rather than waiting for regulators to deliver detailed requirements. In particular, the firm avoid treating rules and regulations as given, and instead actively facilitate discussions about how best to comply with them and, if necessary, how to modify them so that the firm can afford the material improvements that occur for compliance.

This approach helps avoid blind compliance and resource waste, improves compliance efficiency, reduces compliance costs, and ensures compliance not just for the sake of it, but for better development.

4.4.4. Professional External Advice

Firms can seek advice from external consultants or legal advisors on complex regulatory issues and compliance requirements.

5. Conclusions

Based on the regulatory environment of Chinese accounting firms and the characteristics of small accounting firms, this paper studies the compliance challenges that small accounting firms may face, and puts forward several compliance measures that can be widely applied, hoping to help small accounting firms cope with the compliance challenges, reduce compliance risks, enhance flexibility and lay a foundation for sustainable development of firms.

Small accounting firms can set short-term and long-term compliance goals, adopt appropriate compliance measures, formulate a detailed and feasible compliance plan in line with their own conditions, and implement it effectively, so as to better cope with compliance challenges, systematically identify and deal with existing and potential compliance risks, and enhance internal control and governance

capabilities to achieve compliance goals. This will not only help small accounting firms meet regulatory requirements and increase the trust of regulators, but also enhance the trust of clients and the public, enabling small accounting firms to remain competitive in the complex compliance environment and ultimately gain a sustainable competitive advantage.

References

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