Regulation of Statutory Audit in China

Elisabeth Bertin\(^a\) and Jacques Jaussaud\(^b\)

\(^a\)Université François Rabelais de Tours, Institut d’Administration des Entreprises, 50, avenue Jean Portalis – BP 0607, 37 206 Tours Cedex 03, France.  
E-mail: bertin@droit.univ-tours.fr

\(^b\)Université de Pau et des Pays de l’Adour, Institut d’Administration des Entreprises, Avenue du Doyen Poplawski – BP 575, 64 012 Pau Cedex, France.  
E-mail: jacques.jaussaud@univ-pau.fr

In China, following the growing number of scandals in recent decades, the statutory auditor’s role and tasks have been questioned. This paper deals with the evolution of statutory audit in China, which aims to define high standards of auditing in order to protect the public interest. In this article, we discuss the current conditions for statutory audit in China to clarify who may be recognized as a qualified professional, specify the scope of relationships with clients and determine the manner in which professional discipline is maintained. Furthermore, we clarify the content of the statutory audit mission in China as defined by new standards of auditing. Where meaningful, we contrast the Chinese audit system with systems in industrialized countries, such as France and the United Kingdom, and note significant differences between China and those countries in a legal framework and professional standards. Although the context of the globalization of financial markets means ongoing reforms tend to bring statutory audit systems closer, specific features yet remain to be characterized.


**Keywords:** statutory audit; independence; reform; China; France; the United Kingdom

---

**Introduction**

Recent disclosures of frauds and questionable accounting practices in China have considerably shaken investor confidence in the reliability of financial statements and statutory audit. In 2001, for example, out of a sample of 32 audit reports issued by 16 auditing firms, the National Audit Office discovered 23 erroneous reports by 14 of these firms. The errors related to listed companies and amounted to 7.14 billion yuan, that is, approximately €1 billion (*South China Morning Post*, 27 December 2001).

It is not the first time that such events have occurred in China. In the 1990s, several scandals (*Shenzhen Yuanyie* in 1992, *Hainan Zhongshui Group* in 1994, and *Hunan Zhongshui Group* in 1995) Ukraine
Yin Guang Xia in 1999) led to important financial losses for shareholders. The companies involved and their auditors were brought to justice.

Western investors cannot remain indifferent to such occurrences, as China is the world’s second largest recipient of foreign direct investment (FDI). For instance, China received US$45 billion from such investments in 1998 (Beijing Review, 1998). In addition, Shanghai and Shenzhen Stock Exchanges, which opened in 1990 and 1991, respectively, trade shares offered to non-residents. In order to better control the inflow of foreign capital invested in the country, and to strengthen foreign investor confidence, Chinese authorities have noted how crucial it is to increase reliability in accounting and financial information. As a result, statutory auditing should be improved, on the basis of more widely accepted international practices.

This paper will emphasize the main differences in statutory auditing between China and other industrialized countries, such as the United Kingdom and France. Such differences are likely to explain some of the difficulties that foreign investors in China face when they try to assess risk in buying shares, investing in a joint venture or doing business with a Chinese partner. To the best of our knowledge, few articles have been published on statutory auditing in China, either in academic or professional journals.

In the following paper, the reasons and the process of development of statutory auditing in China are analysed; the conditions one has to satisfy to be entitled to carry out statutory auditing are examined; and the content of the audit mission in China is presented.

Recent Development of Auditing in China

China had a very specific economic system until 1979, which explains why the audit profession has developed there only recently. The legal framework of auditing has been established within the context of the economic reforms introduced since that date, which prepared China for a market-regulated economy (Ma, 1990; Xie, 1995).

This process of transition to a market economy has been based on strong inflows of FDI, and the increasing diversity of the legal structures of firms (state-owned enterprises, cooperatives, joint ventures with foreign partners, foreign-owned enterprises, and so on). As a result, the traditional accounting framework had to be completely renewed. With the establishment of Shanghai and Shenzhen Stock Exchanges in 1990 and 1991, respectively, and the overseas listing of some leading Chinese companies, it appeared that China needed more widely accepted rules of accounting and auditing.

Accounting has been dramatically reformed since 1993. New accounting principles have been released (Decree of November 1992, Accounting Law of...