

# The Impact of the Implementation of the New Securities Law on the Audit Industry

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## Abstract

On December 28, 2019, the new securities law, which has been revised for six years, was deliberated and adopted, and officially took effect on March 1, 2020. This is the most important revision of China's securities law since its implementation for more than 20 years. Compared with the original securities law, the core of this revision mainly includes four aspects: comprehensively implementing the reform of the registration system, strengthening the requirements of information disclosure, increasing the cost of violations of laws and regulations, and improving the investor protection system, which has compacted the legal responsibilities of market participants, especially requiring intermediaries such as accounting firms to abide by the law and be diligent. It plays a vital role in improving the basic system of China's capital market and promoting the healthy development of China's capital market marketization and legalization reform. This paper focuses on the impact of the implementation of the new securities law on the audit industry and the countermeasures that accounting firms should take.

## Keywords

New Securities Law; Audit Responsibility; Audit Risk.

## 1. Introduction

Today, the capital market is in a period of great change, and the regulatory environment of the capital market is related to the development fate of China's financial economy. In order to standardize the issuance and trading activities of securities transactions, strengthen the protection of investors and maximize the protection of social public rights and interests, the new securities law has been revised and improved many times, which was deliberated and adopted on December 28, 2019 and officially promulgated and implemented on March 1, 2020. In this revision, the securities law systematically summarizes the practical experience of China's capital market reform and development, regulatory operation and risk prevention and control over the years, and carries out comprehensive reform and improvement from the aspects of securities issuance system, strengthening investor protection, enhancing the quality of information disclosure, vigorously improving the cost of securities violations, and compacting the legal liability of intermediaries. The new securities law promotes the internal integration of marketization and legalization of financial system. Aiming at the institutional obstacles of rule of law in the process of financial operation, it puts forward a series of institutional measures for reform and improvement, which has a significant impact on promoting the long-term healthy development of capital market and improving the quality of listed companies.

Listed companies are an important pillar force in the operation of the capital market. Improving the quality of listed companies is an internal requirement to promote the healthy development of the capital market and an important content to accelerate the improvement of the socialist market economic system in the new era. The improvement of the quality of listed companies

not only needs to improve the internal governance ability, but also external intermediaries can play a certain role, especially the "close" partner of listed companies and the gatekeeper of capital market - audit institutions. At the same time, under the background of the reform of the current registration system, it is emphasized that on the basis of full information disclosure, the choice initiative of the securities market is transferred from the government to investors. Investors' decision-making mainly depends on the external disclosure information of listed companies, which includes information reflecting the company's capital structure, industry development prospects and other information affecting investors' judgment, involving accounting, auditing, taxation and other relevant professional knowledge. Therefore, it assists and supervises the gatekeepers of listed companies to provide information in these professional fields. Its practice quality and professional responsibility will play a key role in the level of information disclosure of listed companies.

As one of the important intermediary service institutions in the capital market, audit institutions should be cautious, diligent, conscientious and responsible, urge listed companies to improve the quality of financial information, and their practice quality and credibility are very important to the healthy development of the capital market. However, the systematic financial fraud of listed companies is highly hidden and difficult to supervise. It is also common for audit institutions to help listed companies issue false financial reports in violation of regulations. The interests of investors are still being threatened, and the practice quality of audit institutions can not be effectively guaranteed. In this context, the new securities law has made a series of rectification measures for audit institutions, further strengthening the protection of investors and compacting the legal responsibilities of audit institutions from the aspects of canceling the audit business threshold, increasing the cost of violations of laws and regulations, strengthening information disclosure and clarifying the division of Accountants' responsibilities. At the same time, the audit risk of Certified Public Accountants is further strengthened, and the audit business competition among accounting firms is intensified, which poses a greater challenge to the professional level of accounting firms. Based on this, what is the change trend of the audit quality of accounting firms after the implementation of the new securities law?

The content analysis of this paper is mainly divided into the following three parts: a general analysis of the highlights of the current round of amendments to the new securities law; Opportunities and challenges faced by the audit industry under the background of the new securities law; Put forward relevant countermeasures to accounting firms.

## 2. Key Points of this Revision of the New Securities Law

The following is a summary analysis of the highlights of this revision of the new securities law from four aspects.

(1) One of the core highlights of this revision of the new securities law is the comprehensive implementation of the reform of the registration system, which is the third revision of the issuance system in the long-term development of China's capital market. The securities issuance system has changed fundamentally from the initial planned issuance to the approval system (which has existed for a long time), and then further developed to the pilot implementation of the registration system with the science and innovation board, and then to the comprehensive implementation of the registration system reform.

(2) Information disclosure system is not only the cornerstone of the capital market to improve the quality of listed companies, but also an important means to protect the rights and interests of investors. High quality information disclosure level can effectively reduce the degree of information asymmetry between investors and listed companies, which is conducive to

investors' reasonable judgment and rational decision-making, so as to improve the resource allocation rate of capital market.

The new securities law adds a special chapter on information disclosure in this revision, which systematically improves the information disclosure system, mainly including expanding the scope of information disclosure, clarifying the principles of information disclosure, emphasizing that enterprises should fully disclose the relevant information for investors' value judgment and decision-making, and stipulating that enterprises can have voluntary disclosure in addition to disclosing relevant information according to law.

(3) Chapter VI of the new securities law has improved the investor protection system from "before, during and after" and will protect the legitimate rights and interests of investors throughout the whole process of securities trading. Investors are the core subject of the securities trading market, which is related to the resource allocation rate and long-term development of the capital market. Investor confidence is the internal driving force for the stable and healthy development of the capital market and the fertile ground for securities issuers to take root in the capital market. Therefore, protecting the legitimate rights and interests of investors is the primary task of maintaining the operation of the capital market. The new special chapter on investor protection system is one of the important highlights of the revision of the new securities law. Taking the protection of the legitimate rights and interests of investors as the legislative core is conducive to enhancing the confidence of investors to participate in securities trading in the capital market and further consolidating the legal foundation of the securities trading market.

(4) For a long time, violations of laws and regulations in the A-share market have emerged one after another, and the administrative punishment of regulators is also increasing. However, due to the imperfect current laws and regulations, the mismatch between violations and punishment, the illegal cost is difficult to deter violators, which has been criticized by people. For example, taking the major financial fraud cases of KangMei pharmaceutical and KangDexin as an example, the amount of financial fraud involved by these two enterprises is calculated in billion, and according to the punishment intensity of the original securities law, the maximum fine is only 600000 yuan. Obviously, it can be seen that the punishment intensity of the original securities law for major violations is too light, which can not play the due deterrent effect on violators. In this case, it is urgent for the new securities law to strengthen the punishment of violators and strengthen the control of violations in the process of capital market development. The new securities law not only increases the punishment for fraudulent issuance by issuers, but also puts forward higher requirements for intermediaries as important responsible persons. It is clear that intermediary service institutions should return to their positions and fulfill their responsibilities and do their own work well. If they operate in violation of regulations due to bad behaviors such as interest inducement of issuers, they will face huge costs of violation of laws and regulations, Intermediary service institutions are bound to lose more than gain.

Therefore, the new securities law increases the punishment for violations of laws and regulations, which not only requires issuers to abide by discipline and law, but also aims to force intermediary service institutions to improve their self-discipline and professional service ability, so as to compact the legal responsibilities of "gatekeepers", urge intermediary institutions to be diligent and conscientious, and better maintain the management order of the capital market, It is conducive to the long-term, healthy and stable development of the capital market.

### 3. Opportunities and Challenges Faced by the Audit Industry under the Background of the New Securities Law

On the basis of systematically summarizing the practical experience of China's capital market reform and development, supervision and law enforcement, this revision of the securities law comprehensively implements the injection system, increases the cost of violations, improves investor protection, further strengthens information disclosure, cancels relevant administrative licenses, and compacts the responsibilities of intermediaries. As the fundamental law of the capital market, the new securities law not only brings new opportunities to the audit industry, but also significantly improves the audit practice risk, which will have a long-term and far-reaching impact on the CPA industry.

(1) Intensified competition in audit business: the new securities law cancels the audit qualification of securities business and changes it to "double filing". Article 160 of the new securities law stipulates that engaging in other securities service businesses shall be reported to the CSRC and the Ministry of Finance for the record. This provision marks the end of the 28 year securities business qualification. The number of accounting firms engaged in Securities and futures business will increase in the short term. Some firms without securities business qualification will join the audit of securities and futures business. Some large firms mainly linked by securities and futures business qualification may disintegrate and form more firms. Generally speaking, the supply side data of accounting firms engaged in Securities and futures business will increase. The new securities law changes the business qualification from the examination and approval system to the filing system, which means that the financial statement audit business of listed companies monopolized by 40 accounting firms with securities business qualification approved by the CSRC of the Ministry of finance will be participated by more accounting firms after applying for filing, which will further aggravate the competitive pressure of the industry.

(2) The audit risk has increased significantly: "financial fraud seriously challenges the seriousness of the information disclosure system, seriously destroys the integrity foundation of the market, seriously destroys market confidence and seriously damages the interests of investors. It is a 'cancer' of the securities market and must be dealt with resolutely and severely." Yan Qingmin, vice chairman of CSRC, stressed at the 2020 annual meeting of China Association of listed companies and the 10th meeting of the Second Council on June 6. This means that the consequences of audit failure are more serious. The new securities law not only increases the punishment for accounting firms who fail to perform their duties diligently, and the documents produced and issued have false records, misleading statements or major omissions, but also stipulates that "if losses are caused to others, they shall bear joint and several liability with the client", and adds a representative litigation system in Article 95, This will greatly expand the civil liability of certified public accountants. In case of audit failure, certified public accountants need to bear credit liability and even criminal liability in addition to the above-mentioned administrative punishment and possible huge civil compensation liability. In particular, the audit failure cases of ZhongHua Institute Ya BaiTe, Zhong Tianyun Institute Guangdong media, LiXin Institute \* ST Sinopharm and the recently discussed cases of KangMei pharmaceutical and Kang DeXin in the media have pushed relevant accounting firms and certified public accountants to the forefront of the storm, Under the regulatory policy of maintaining "zero tolerance" for financial fraud and violations and adhering to "multiple investigations in one case", the probability of CPA audit failure being found and punished is higher and the consequences are more serious.

As an important defense against corporate fraud, CPA audit plays an important role in maintaining the economic order of China's capital market, reducing information asymmetry and improving the credibility of information such as financial statements of listed companies.

However, from the previous understanding of the 19 administrative penalties received by the firms under their jurisdiction from 2016 to June 2020, there are still many problems in the industry. First, the integrated management of the firm is not in place. There are 12 punishment projects undertaken by branches, accounting for a high proportion. Second, it did not pay enough attention to the risk of fraud. The undersigned certified public accountants do not have enough doubts about their practice, have weak risk awareness, have limited means to investigate fraud, and do not pay full attention to the imperfect corporate governance, deteriorating operation and abnormal cash flow. Third, the quality control system failed. The competence and independence of quality control reviewers are insufficient, and no problems related to punishment are found in most project reviews; Some quality control review personnel are held by the personnel of the branch office, but the head office did not participate. There is no substantive rotation, and there is rotation of the same branch, within the project team and the original review partners. The monitoring proportion is low, and only two projects are clearly monitored. The above problems are common in most firms, but under the litigation mechanism of "implied accession" and "explicit withdrawal" based on investor protection in the new securities law, the legal liability and practice risk of firms will be further strengthened. At present, many firms are involved in civil litigation. Article 163 of the new securities law has defined the joint and several liability of securities service institutions. In the future, a single lawsuit may bring huge compensation.

(3) Significantly enhanced audit responsibility: the core of the reform of the new securities law is to strengthen information disclosure. Previously, ShenZhen Stock Exchange, Shanghai Stock Exchange and stock transfer system successively issued notices requiring listed companies to disclose information related to the appointment of accounting firms, including basic information of accounting firms, project team members, investor protection ability, independence and integrity. This is the first regulation related to accounting firms issued after the implementation of the new securities law, marking the implementation of relevant supporting measures of the new securities law. From this provision, we can preliminarily see the future supervision ideas and direction of the regulatory authorities, that is, they have begun to strengthen the supervision of the independence, competence and integrity of firms and certified public accountants.

In this case, the accounting firm undertakes the audit project of securities issuance, audits the financial information of the issuer, and gives an audit opinion on the financial status of the issuer. The audit opinion has become an important basis for each participant to judge the investment value of the issuer. Under the registration system, the role of the issuance supervision authority in the issuance of new shares has changed. As long as the issuer meets the conditions of full information disclosure, it can register the issuance. In this case, securities qualified accounting firms, based on independent third-party professional institutions, issue objective and fair audit reports on the issuer's financial situation, which will become the main basis for investors to judge the issuer's value. Under the approval system, investors' expectations for the value judgment of the issuance regulatory authority will be transferred to the securities qualified accounting firm that directly provides judgment information. Therefore, the previously weakened functions of the securities qualified accounting firm will be returned, and its responsibilities in the process of new share issuance will be greatly strengthened.

In view of the possible changes in the industry after the implementation of the new securities law, as certified public accountants and firms, we should continue to promote and improve internal governance, partner mechanism, quality control system and information platform from within the firm, so as to ensure the provision of high-quality audit services for the capital market, so as to meet the challenges brought by the new securities law.

## 4. Proposal

The new securities law has brought a change to the audit industry. In the face of the change, the independent audit industry will usher in another spring of development. All accounting firms have an opportunity to prove or rewrite themselves again. In view of the new requirements of the new securities law on the audit industry, this paper puts forward the following suggestions:

(1) Improve the risk control system. "Fear the market, the rule of law, profession and risk" was put forward by Yi Huiman, chairman of the CSRC, at the press conference on "establishing a science and innovation board and pilot registration system" in February 2019. It is also an important principle that accounting firms and certified public accountants must follow in their practice. Under the background of registration system reform, securities qualified accounting firms have strengthened their responsibilities in the process of new share issuance. At the same time, facing the strict punishment system of the issuance regulatory authority, the overall IPO audit risk of securities qualified accounting firms has increased to a certain extent. In order to improve the ability of risk control and audit quality, we should improve the risk control system of IPO audit business of securities qualified accounting firms. The risk control system of IPO audit business consists of four aspects: pre audit control, audit site control, post audit control and top-level organization setting of risk control. Pre audit control is to make a preliminary assessment of the audit risk of the IPO audit object, make a detailed analysis of the core competitiveness of the audit object, compare and analyze the current operation data of the audit object with the operation data of benchmark enterprises in the same industry, and comprehensively use other means to eliminate high-risk customers. The on-site audit shall be in direct contact with the real data, so as to ensure the high sharing of risk control information between the project team and the senior management, and grasp the risk points on the audit site in time. Post audit control is to establish IPO audit quality control system, which is composed of multi-level quality review and improve the risk control system. Establish a top-level organization for risk control of IPO audit business, such as the IPO audit committee composed of senior professionals, conduct overall control over the risk points of early warning of the risk control system, and conduct top-level framework and coordination for the operation of the risk control system.

(2) Reserve excellent audit talents. Audit is actually a very complex work. It requires not only profound financial knowledge, but also rich professional experience, keen professional judgment and good communication skills. Talents with these conditions are very scarce. In the past, due to insufficient attention to audit quality, most audit talents were difficult to obtain good treatment and development opportunities in the social audit industry, so they lost seriously. Now, the era of reflecting their value has come. Which accounting firm takes the lead in obtaining talent advantage, which accounting firm can obtain competitive advantage and stand out in the fierce competition.

(3) Change the internal management system. Under the background of the reform of securities issuance registration system, the high requirements for the quality of information disclosure make the audit risk of accounting firms have an upward trend, and put forward higher requirements for the internal management mode of accounting firms, especially the branch management mode. The implementation of the integrated management mode of head office and branch office by securities qualified accounting firms plays a key role in improving the ability of risk control and risk resistance. Specifically, the branch office implements highly integrated management in terms of business undertaking, personnel allocation, financial resources and quality control, so as to make the whole process of securities issuance highly interconnected with the information of the head office, make efficient use of the audit technical support of the head office, and the audit business of the head office is fully in the overall risk control system, So as to improve the quality of IPO audit under the background of registration system reform.



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