

Audit Quality Control:
Big Four Global Member Firms and Audit Services

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Abstract

“Big Four” stands for PricewaterhouseCoopers, Deloitte, KPMG, and Ernst & Young, the largest four public accounting firms. They dominate the professional accounting services market and provide high-quality audit services. Each Big Four global member firm is independent and

legally separated from each other. Local accounting firms simply borrow the name and reputation of the Big Four and become affiliate firms. This organizational structure leads to the variability of the audit quality in different regions, depending on the social, institutional, and cultural influences. Using Hofstede's six dimensions of national cultures and S. J. Gray's model of accounting system values, this paper examines the audit quality of the Big Four global member firms in China, Japan, and Eastern Europe. This paper also analyzes the benefits and disadvantages of Big Four localization and predicts how the Big Four will adjust to cultural influences while they strive to improve audit quality.

Keywords: Big Four, public accounting, audit quality control

Introduction

The Big Four and Global Network

The "Big Four" stands for the four largest CPA firm networks in the world: PricewaterhouseCoopers, Deloitte Touche Tohmatsu, Ernst & Young, and KPMG. All four firms share a similar organizational structure. Each has an international headquarters led by a chairman or CEO. The chairman coordinates member firms in various areas of the world.

Take KPMG as an example. KPMG International Cooperative headquarters is in Switzerland, a legal entity established under Swiss law. While headquarters do not provide any professional services, it markets its brand name and affiliates many accounting firms. KPMG Limited Liability Partnership UK is a separate and legally independent CPA firm that hires locally, provide services to companies located in the UK, and is managed by senior partners at KPMG LLP UK. (KPMG, 2013, p2).

At the headquarters office, besides the chairman, an Executive Board is responsible for assigning partners, oversee operations at each firm, and constructing strategy and develop

standards for firms to adhere. Consequently, all member firms share one set of values, one universal code of conduct, and a widely-applied systematic procedure such as specific requirements to initiate an engagement, audit planning, or substantive tests.

Locally, each firm is a for-profit entity, owned and invested in solely by the partners. There is no ownership between each member firm nor between headquarters and member firms. Each local firm reports only to the local government and accounting authorities. For instance, Deloitte is registered with the Canadian Public Accountability Board (CPAB) to perform audits of Canadian public companies and with the U.S. Public Company Accounting Oversight Board (PCAOB) to perform audits of U.S. public companies. Our firm is also registered with audit regulators in countries that are part of the European Union, European Economic Area and Asia. Our audit partners and professional staff members are also subject to the requirements of their applicable Provincial professional bodies (Deloitte, 2015, p3)

Localization requires firms to comply with local laws and local audit standards. Firms that audit multinational companies must also report to the company's home-country regulators. About 28% of PwC's clients are Fortune 500 multinational companies (PwC, 2015, p23).

Adding to the complexity, senior partners at each member firm have the ultimate control, assume all risks, and assume liability. Since it costs them a fortune to be a shareholder, and their earnings are based on revenues, partners have incentives to adopt localized strategies that best assist the member firms to increase revenue and reach out to bigger clients such as Fortune 500 companies. If there is a conflict between partners' personal interests and the operational objectives of the firm, partners may eventually violate ethical codes of conduct. Even worse, in

some developing countries, the lack of supervision and the overwhelming social norm may influence partners to believe that unethical behaviors are acceptable.

Besides conflicts of interest that may affect a partner's judgement, legal requirements add complexity to Big Four's global operation. Some Big Four firms are subject to inspections by two regulators. Under Section 106 of the Sarbanes–Oxley Act of 2002, a foreign public accounting firm that audits a U.S. issuer is subject to SEC 106 “in the same manner and to the same extent as a public accounting firm that is organized and operates under the laws of the U.S.” (Sarbanes Oxley Act, 2002). To ensure the interests of U.S. shareholders, PCAOB, who “maintains bilateral contact with many jurisdictions around the world” (PCAOB, 2015), inspects foreign registered public accounting individually or jointly with the home country regulators. PCAOB inspections provide authorized and professional opinion on the audit quality

Take Alibaba, a U.S. publicly-traded company that is based in China, BABA (NYSE), as an example. Its auditor, PwC Hong Kong, must “produce its audit work papers for the PCAOB or SEC in connection with any investigation...[and is] subject to the jurisdiction of the courts of the U.S. for purposes of enforcement of any request for production of such work papers” (Sarbanes Oxley Act, 2002). If documentations are not received by SEC in a timely manner, the SEC might eventually delist Alibaba from New York Stock Exchange. Audit firms will also take the liability (Sarbanes Oxley Act, 2002). Lawsuits brought up by SEC against an overseas U.S. issuer because of the poor quality of financial statements also reveal the actual audit conduct in certain countries.

Hofstede's Six Dimensions of National Cultures and Prior Research

Geert Hofstede is a social psychologist from the Netherlands and a professor at Maastricht University. He is famous for the research on dimensions of national cultures. In his research, six

cultural variables: power distance, uncertainty avoidance, individualism versus collectivism, masculinity, long- versus short-term orientation, and indulgence, can be used not only to understand a country but also its auditing systems. 1). Power distance refers to the extent to which people with low social status accept the inequality in the society (Hofstede, 2001, p297). 2). Uncertainty avoidance describes how much ambiguity or uncertainty a society can tolerate or attempt to ignore (Hofstede, 2001, p297). 3). Individualism/ Collectivism index quantifies how independent or dependent on the group people are (Hofstede, 2001, p297). 4). Masculinity means that in a society, “Social gender roles are clearly distinct. Men are supposed to be assertive, tough, and focused on material success; women are supposed to be more modest, tender, and concerned with the quality of life” (Hofstede, 2001, p297). 5). Long-term and short-term orientation address the difference between a focus on the future and a focus on present benefits. 6) In an indulgent society, people are free to pursue what they love with little restrictions. In a restrained society, people tend to follow the rules and social norms and tend not to do anything deemed to be improper or unacceptable. It is expected by the accounting authority and shareholders that audit services are provided by firms in the most professional way. However, cultural factors are unavoidable. In some societies, regulations can be enforced strictly. For instance, in the United States, auditor independence, both in fact and in appearance, is evaluated and approved by the Audit Committee. Upon serious violation, a CPA faces the risk of losing his or her license. In other countries, auditors are not independent, and they are subject to clients’ pressure.

In other research by S.J. Gray, Hofstede’s cultural and societal factors are linked to accounting practices to derive four dimensions of accounting values (Gray, 1988, p1). Those four dimensions are as follows: 1). Professionalism addresses the preference for the self-regulation,

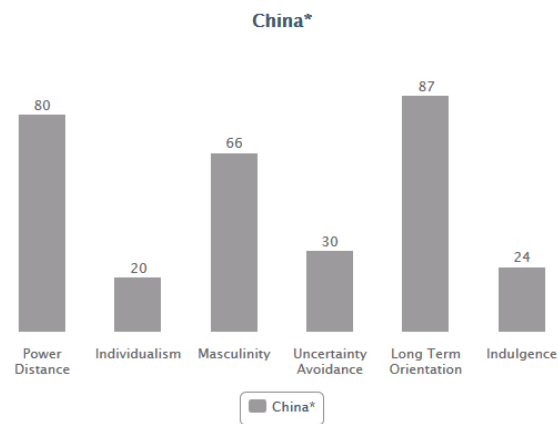
self-judgement and legal requirements. In the U.S. and U.K. where the history of the accounting professional association is substantially longer than developing countries, audit practices improve and change based on the experience of independent professionals (Uchenna, 2016, p233). Gray argues that the more individualist and the less tolerant to uncertainty a country is, the more professional it tends to be (Gray, 1988, p9). China with an index of 20, Japan - 46, and South Korea – 18, are just some Asian countries that stress group achievement rather than fulfillment of personal needs. In fact, accounting practices are regulated by the government in these countries. 2). Uniformity, versus flexibility, affects the attitudes towards adherence and compliance to auditing standards. Individualism and uncertainty avoidance are closely connected to the extent of uniformity and flexibility (Gray, 1988, p10). 3). Conservatism refers to the fundamental attitudes towards taking a cautious or risky approach when dealing with tricky problems that require subjective judgments. If a country ranks low on uncertainty avoidance and high on individualism and masculinity, it is more likely that it will take a bold approach (Gray, 1988, p10). 4). Secrecy is used to describe the protection of confidential information. Both are significant to business and accounting, and they seem to contradict each other. Confidentiality has always been a fundamental accounting attitude in business relationships and accounting practices (CIMA, 2010). Managers keep internal operational information as a secret “recipe” to protect intellectual properties, but the financial reporting must be transparent to the public and to authorities upon request.

China

Since the economic revolution in the 1970s, China has managed to transform away from a Communist economy. Striving to become integrated into the global market, China has become the largest developing country. Although the auditing profession has made progress, the audit

quality control by the Big Four in China is still insufficient, because auditors lack independence due to the reliance on *guanxi* with clients (Gillis, 2011, p3).

At its most basic, Guanxi describes a personal connection between two people in which one is able to prevail upon another to perform a favor or service, or be prevailed upon. The two people need not be of equal social status...Guanxi can also be used to describe a network of contacts, which an individual can call upon when somethings needs to be done, and through which he or she can exert influence on behalf of another. In addition, Guanxi can describe a state of general understanding between two people: “he/she is aware of my wants/needs and will take them into account when deciding her/his course of future actions which concern or could concern me without any specific discussion or request” (Pierre; Penner. 2009. P48)



Observing Hofstede’s cultural indexes of China, one will notice that Chinese people are not very individualist. They are also comfortable with inequality. Chinese are also not threatened by ambiguity. For example, very few publicly traded companies in China were private. Government is usually the most influential shareholder. Therefore, most companies do not feel they are obligated to present financial statements fairly for the public, and the public accepts the

idea that they are not important enough for the company. Chinese people value collectivism. For companies, it is a greater honor to make a contribution to the GDP growth. For auditors, it is smarter to obey the seniors, maintain the harmonic atmosphere at the office, and make selfless contributions to the reputation of the firm, rather than showing off one's personal talent or making objections.

The Chinese professional accounting system values statutory control, instead of professionalism. CICPA (Chinese Institute of Certified Public Accountants) was established in the late 1980s and has been regulated by the government. The majority of Chinese CPA firms were also sponsored and are regulated by the state government (Deng, Macrve, 2012, p6). Auditors' salaries are provided by the government regardless of the audit quality. The government does not fully understand "the economic role of CPA industry and considered auditing as an expansion of the government's own administrative sphere" (Deng, Macrve, 2012, p6).

Guanxi and Auditors' Independence

Chinese auditors do not always follow the standards. Especially when auditors and clients have built a personal relationship, or *guanxi* in Chinese. Thus auditors are willing to break rules for the clients as a personal favor to maintain this *guanxi*.

Managers want to build a personal relationship with audit firms and auditors, because they hope auditors will do them a "favor". Chinese issuers manipulate earnings to achieve the profitability level set by the government (Deng, Macrve, 2012, p7). If they have three years of losses, companies will be delisted from the stock exchange. The Big Four in China have evolved from local accounting firms that have gone through a disaffiliation program and are no longer

owned by the government. However, it is still difficult for auditors to distance themselves from clients because of historical ties (Gul et al., 2010; L. Yang et al., 2003).

There are about six thousand small and private accounting firms in China. They go after short-term profits and are dismissed in less than four years if there are a lack of professional practitioners (Jui, Wong, 2015, p40). These firms do not worry about keeping good and long-term relationships with their clients. In contrast, large accounting firms such as the Big Four are proud of having partnerships with big-name clients. To attract clients, it is common for firms to break ethical codes during the recruiting process of Chinese Big Four. Nepotism is an open secret. Children whose parents are managers of Fortune 500 companies will be hired, even if they are not technically qualified. This way, the Big Four will have access to develop *guanxi* with big clients.

In the masculine Chinese culture, to some extent, “auditors’ and firms’ reputations are established and maintained by fulfilling the obligations of *guanxi*, rather than reporting opinions fairly and trustfully” (Hua et al, 2010, p3). Clients are also well aware of this pressure on auditors. They exert pressure on auditors so that they will not undo the earning management (Du, Ronen, Ye, 2015). Usually, the larger the corporate client is, the higher the probability of the accounting firms’ willingness to collude in its auditing practice. That is, the bigger corporations have more money to buy favoritism from accounting firms in China, acting as their external auditor (Lee, 2015, p143).

Guanxi is embedded into Chinese culture. People have the tendency to keep these historical ties and do business this way. In China, auditors operate in a less litigious environment that also lacks traditional corporate governance mechanisms (Gul et al. 2010). Most companies

want to work with auditors who are willing to conceal fraudulent transactions or, at least, increase earnings for them. Holding up integrity and ethics is respectful but also can make an auditor become unemployed. Therefore, even the Big Four, whose audit quality is supervised and monitored by global headquarters, have to localize into the Chinese culture so that they stay and are welcomed by Chinese clients.

SEC v. Big Four in China 2014

The traditional auditing profession in China is more secret than transparent. This characteristic can be seen in the low uncertainty avoidance and high power distance scores. Auditing firms, as well as other financial service industries such as financial rating firms, are subject to one type of conflict of interest: they evaluate the financial statements of the very entity that is paying for their services. So do the Chinese affiliates of the Big Four. Both audit firms and their clients believe that financial information should remain confidential, even though they have raised millions of dollars from shareholders. Chinese audit firms are so used to keeping this secret, and they did not get any sanctions by the Chinese government or denouncements by the Chinese public. However, Chinese firms have been asked to regularize and standardize their behavior by some international professional communities (PCAOB, 2013, p1).

In January 2014, the Chinese affiliates of the Big Four were required by the SEC to provide audit work papers for some of the mainland companies listed on the U.S. stock market (Rapoport, 2012, p1).. These big companies include Alibaba, the company who had the highest IPO in history, and JD.com Inc., the largest B2C E-commerce company in China. These companies have raised billions of dollars from U.S. investors who have remote access to safeguard their assets.

In fact, in 2013 PCAOB already had several negotiations with China Securities Regulatory Commission (CSRC) who prohibited Chinese Audit firms from providing documentation to foreign governmental authorities. CSRC agreed to improve the accuracy and reliability of audit reports to protect investors and to promote public trust in the audit process and investor confidence. Both also agreed to exchange information for the purpose of enforcing, and securing compliance with the Laws, rules, or regulations applicable in their respective jurisdictions (PCAOB, 2013, p1). Chinese multinational companies, on one hand, want to raise more capitals from the global market. On the other hand, they resist respecting international standards. Chinese Big Four firms, who are just local, traditional firms also insist on doing business with clients in a way they are comfortable with, unwilling to improve their services to become more professional and transparent..

The SEC worries about the outlook of U.S.-listed Chinese companies. From 2010 to 2014, the SEC has kept negotiating with the Chinese affiliates of the Big Four, but the firms always refused to provide audit work papers requested by the SEC as part of investigations of financial reporting fraud (Rapoport, 2012, p1). In February 2014, the SEC brought a lawsuit against the Big Four for breaching The Sarbanes-Oxley Act section 106. In court, the Big Four claimed that they were prevented from sharing the work papers by strict Chinese laws that treat such documents as akin to state secrets (Rapoport, 2015, p1). State secrets might include operational secrets of Alibaba and mandatory funds invested by Alibaba to public projects. The Big Four refused to turn in the audit work papers. Eventually, SEC had to suspend Chinese Big Four from auditing listed U.S. companies in China.

The suspension affected and jeopardized the operation of a dozens of Chinese multinational companies. After the suspension, public trust of Chinese companies diminished. The stock price of the public-traded company Alibaba dropped from 103.60 on Jan 1 to 85.00 on Feb 5¹ 2016, the week before the lawsuit settlement. U.S. and global investors were no longer willing to invest in these U.S. issuers audited by the Chinese Big Four. The stock-price decline put the Chinese Big Four under pressure, and Big Four started to consider settle the case. As for some Chinese Reverse Mergers companies, the SEC has been warning U.S. investors about the risks of CRM companies, because they were involved in manipulating share prices to meet listing requirements and their auditors participated in cooking the books. 94% of the auditors of the CRM companies were small U. S. CPA audit firms that are subject only to a triennial PCAOB inspection (PCAOB 2011, p. 6). Even though Chinese companies had a notorious reputation and had been a concern of the SEC and PCAOB for a long time, this was the first time the SEC suspended a Chinese Big Four firm, after trying every possible way to communicate with them.

The SEC attempted to seek work papers related to an investigation of Longtop Ltd. from Deloitte Touche Tohmatsu Ltd. Shanghai. Longtop was suspected of having numerous improprieties during an audit in 2011. In May, Deloitte resigned. The PCAOB issued a study that alerted investors about the recent resignation of Deloitte because the PCAOB were unable ensure the quality of Longtop's financial statements and audit report (SEC, 2011, p1). Efforts made by the SEC to obtain information from an international sharing mechanism was also unsuccessful. The SEC brought an enforcement action against Deloitte Shanghai for willfully violating the Sarbanes-Oxley Act and the SEC act of 1934, because it failed to provide the SEC with audit

¹ Data from Yahoo! Finance. NYSE (BABA).

<http://finance.yahoo.com/q/hp?s=BABA&a=00&b=1&c=2012&d=01&e=5&f=2016&g=d>

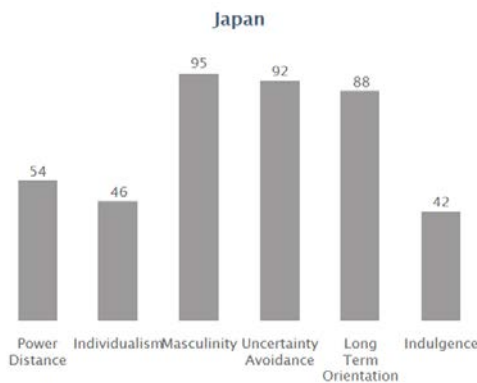
work papers. Eventually, Deloitte did not provide any work paper, and the SEC had to delist Longtop from the NASDAQ (SEC, 2011, p1). In 2012, there was a similar enforcement by the SEC against the four Big Four firms in China. It was coordinated by Cross Border Working Group. The SEC staff flew to China and investigated the questionable companies (SEC, 2011, p1). The Chinese Big Four firms did not learn from these experiences. They thought they would get away if they kept claiming that Chinese Law prohibited them from releasing information to foreign authorities. Indeed, they were only slightly sanctioned – by reimbursing the SEC staff who traveled to China (NASBA, 2011, p1).

Statutory control and secrecy are the two main characters of Chinese accounting values that can be seen better from the interaction between the Chinese Big Four and U.S. authorities. Even though the Chinese central government has been trying to enforce accounting standards to be in line with international standards, these two cultural factors significantly preclude the global acceptance and trust in Chinese companies and audit quality. Because of the forceful statutory control by government, the Big Four had to affiliate with local accounting firms and became a partial-private network in China. The rest of the CPA firms are all publicly-owned. This structure deprives the auditors' independence and professionalism that the Big Four are famous for. Though under the supervision of the global chairman and senior partners who received an impressive education from top universities, the Chinese Big Four still do not have sufficient audit quality control. Not to mention the rest of the 10,000 CPA firms in China (CICPA, 2014, p1), whose auditors only received degrees from community colleges. Flexibility, in a negative sense, can be used to explain why Chinese auditors always break rules to “make” things work. If the client has a net loss and asks the auditors to help, auditors are willing to violate professionalism and work ethics to provide services that satisfy the customer. Secrecy severely

hurt the reputation of the Chinese Big Four, Chinese companies, and the image of China as a whole. Externally, Chinese companies pretend to adopt global accounting and trading standards, trying to impress international investors. However, deep down, they are still conservative and believe that being transparent financially costs too much. The lawsuit brought up by the SEC is a warning and a lesson to Chinese firms and companies. If they keep disregarding international standards, they will be left out of the global trading game.

Japan

In the recent Case Report from the Audit Firm Inspection Results (CPAAOB, 2014) and a 2006 study about Quality Control of Audits of the Four Largest Japanese Audit Firms (CPAAOB, 2006) – KPMG Azasa & Co., Deloitte Touche Tohmatsu, EY ShinNihon, and ChuoAoyama PwC (before dissolution), materials deficiencies were discovered by the Certified Public Accountants and Auditing Oversight Board (or CPAAOB).



Japanese society has one of the highest scores of masculinity among all countries. Japanese people were educated to compete and to win since kindergarten. Japanese employees are famous for their drive for excellence and detail but also notorious for being workaholics. If one fails to accomplish a task, he or she will do anything to remedy their reputation. However, with a medium-range index of individualism and high uncertainty avoidance, Japanese auditors follow

uniformity and go with the statutory control. That is to say, in an environment such as an audit firm, an auditor's success is evaluated by seniority, obedience to commands, and their relationships with co-workers more than individual achievement.

Accounting Scandals

Japan plays a significant role in the global economy. It has the third highest GDP, gross domestic product, and the 27th GDP per capita in 2015 (IMF, 2015, p1). Japanese are detail-oriented, meticulous perfectionists. International investors have confidence in Japanese enterprises such as Sony, Olympus, and Canon who produce unbeatable-quality products, therefore very few studies had been done about the fairness of financial reporting by Japanese companies or audit quality by Japanese firms. However, in 2005, ChuoAoyama PwC was involved in the Kanebo scandal and later dissolved and reconstructed as Aarata PwC (Dan, Ryo, 2014, p6). In 2011, Azasa KPMG was involved in the Olympus Scandal, causing investors worldwide to question the audit quality of Japanese firms.

Japanese Big Four and The Organizational Culture

Japanese auditors, who are extremely hardworking and detail-oriented, deliver a low-quality audit, because extreme masculinity does not necessarily lead to good results. In modern Japanese society, detail-oriented perfectionists do not commonly exist in white-collar industry any more. People work hard not because they love their jobs nor because they want to be outstanding in the field. First of all, employees work hard to impress the supervisor and keep their jobs. Japan has been struggling to improve their economy for almost a decade now. Even big-name companies are cutting on the human resource budget every year. Some quotes by Americans who have worked in Japan are strong evidence of this point. "My impression seems to be that while people are "working" long hours, a survey of how much time is being spent on

smoke breaks, toilet breaks, sneaky phone calls, long lunch breaks etc. would probably find that the average office worker only does about 5 – 6 hours of work. "Most Japanese do not work hard, they just spend countless hours wasting time on pointless paperwork and irrelevant procedures." ²

Masculinity has caused problems in the office and has negatively affected productivity. Employees do not work hard but simply work longer and waste time to impress managers. Employees do not know how to relax, since they constantly fear losing their jobs. It is clear that extreme masculinity in modern Japanese society does not lead to high-quality work but the very opposite.

The second reason for low productivity can be explained by conformity, an internal pressure on auditors by supervisors, engagement partners, or even co-workers. In a study conducted by Parmod Chand in 2014, Japanese auditors were asked to analyze several questions regarding recognizing questionable assets. Auditors made different decisions when they were solving problems on their own compared to in a group (Chand, p4). The result of the behavioral experiment indicates that the auditor's judgment is affected by conformity. Japanese emphasize conformity and harmony in a work environment rather than individual capacity (Chand, p4). That means even if one has a different opinion, he or she must keep silent and go with the majority. Obedience is also noticed in Japanese firms in the same study. It is obvious that when junior Japanese auditors are under conformity and obedience pressure, they will likely make no decision and all follow the commands of authority. Worst case, even when the command is unethical, staff auditors do not make any objection. They simply spend long hours doing

² Retrieved from forum website: <http://en.rocketnews24.com/2013/08/26/five-things-that-keep-japanese-people-chained-to-their-jobs/>

paperwork. Therefore, the audit quality is not as high as in a diverse environment where everyone can interact and converse about their ideas. In the Kanebo scandal, four auditors who were arrested were all partners aged around 50 (The Telegraph, 2006). They stood for the authority at ChuoAoyama PwC. So, when they said that the consolidated financial statements were good, junior auditors did not question it nor did they dare to object. Hence, even though Japanese auditors work long hours and many of them die from overwork, they lack professionalism, and their knowledge was not utilized in the process.

The third reason why Japanese auditors are not productive is because of the low auditor fees. “Japanese audit firms are typically paid a fraction of what US auditors receive, adding extra pressure” (Perria, 2011, p1). The CPA has become a less attractive career option to college students. In a survey conducted by Boland in 2014, many college students, both accounting major and other majors, did not believe that a CPA job pays a high salary (Sugahara, Boland, 2006). Accounting education in Japanese universities focuses on theories and concepts. CPA training is expensive and mostly delivered by private institutions. Overall, low audit fees have caused a lack of work passion among auditors and a lack of supply of good accounting students, which leads to low-quality audits (Sugahara, Boland, 2006).

Besides the extreme masculinity, low legal liability and the lack of motivation to maintain reputation of Japanese auditors also cause low audit quality. First, in history, Japanese auditors held no litigation liability (Skinner, Srinivasan, 2010). CPAs, especially partners, were not subject to big penalty. They also did not worry about losing their reputation. Financial fraud was the company’s fault. People blamed the company but never the auditors (Skinner, Srinivasan, 2010). Therefore, for individual auditors, they did not have to work hard or be professional to maintain their title or prestige. Moreover, with a high uncertainty avoidance index, Japan has a

long list of companies and audit firms that have been involved in fraud but eventually walked away without even being punished. Similar to the situation in China, auditing does not play an insurance role for financial reporting in Japan, nor will a firm's reputation get severely damaged if involved in fraud (Skinner, Srinivasan, 2010). In the case of ChuoAoyama PwC, ChuoAoyama's reputation was badly hurt, but PwC remained safe and sound (Skinner, Srinivasan, 2010). The reputation of PwC was saved and carried on as one the biggest 4 public accounting firms in Japan. PwC then joint ventured with Aarata, and finally reconstructed as Misuzu PwC that has smaller firms but provide high-quality services to some big-name clients (Nakamoto, 2007, p1). Japanese auditors simply need to perform professionally, keep their integrity, and stay away from another Kanebo so that they remain a good-named CPA. Therefore, since Japanese auditors are not subject to either legal litigation or pressure to earn reputation, they will not work hard during an audit engagement to ensure the quality (McKenna, 2013, p1).

The second reason, which is consistent to low legal liability, is the lack of power or say by audit firms. Yoshinao Matsumoto, a professor of auditing at Kansai University, has expressed his concern of this situation of Japanese auditing profession:

The most typical Japanese audit environment is that the power of business managements is much stronger than CPAs. So CPAs, as auditors, cannot take a firmer attitude toward these directors and managements...The fact that auditor's power is weak compared to the management and that corporate governance, [such as] directors' mutual monitoring, is not effective like in Japanese traditional companies, makes fraud and irregularities easier (Perria, 2011, p1).

The combination of low legal liability and lack of auditing power gives evidence to the declining audit quality in Japan. It also explains why after the 1990 stock-market bubble, Japan

has suffered from corporate scandals, including Kanebo, Olympus, and Toshiba, and accounting frauds that caused misstatement of more than \$1 billion U.S. dollars (McCombs, 2015, p1).

Although Japanese society is modern and developed, it still reserves their authoritative, conservative and secretive financial system. The system needs to be revolutionized and refreshed to ensure that the Japanese economy recovers and restores to a healthy, transparent, and energetic market.

Russia

Having transformed from a centrally planned economy to a globally integrated economy, Russia is characterized as a market that has weak shareholder rights and enforcement of securities regulation (Mironov, Srinivasan, 2013). During the transitional period, certain characteristics of totalitarianism and socialism remained and allowed corruption to keep growing.

The norm, “sale of status opportunities, or the sale of the socialized property rights” (Acemoglu and Verdure, 1996, p59) formed under Russian socialism continues to play an influential role in games in modern Russian society. All public officials are involved in bribery, from local to top. Local officials receive bribery or “gratitude” to commercialize some services under his or her control. Top national heads act like middlemen who take a large portion of benefits from a contract between the government and private business (Борьба с коррупцией в России, 2011). Although bribery is against the law, Russians do not think of it as a crime but rather a cultural and historical root. Other corruption such as commissions and kickbacks are also very common. This point of view can be told from an interview:

The interviewer: Let us assume that corruption is not at present in our society.

The expert: With the current laws?

The interviewer: Yes.

The expert: If the existing laws were fully obeyed, it would be a catastrophe. It would mean that society would stop in its development, the economy would collapse (Acemoglu and Verdure, 1996, p68).

Since bribery is usually done in an informal manner under the table, it leaves little evidence on the books for auditors during evidence gathering. Investors pay attention to fraud auditing but little to corruption auditing, because the latter is more of a political, social, and cultural issue. Especially in Russia, people do not expect auditors to detect corruption fraud. At the least, auditors should examine internal controls, particularly “tone at top” to prevent financial frauds from happening.

The Big Four firms should make efforts and investigate into internal control and corruption as they audit many international companies. Russian companies that are audited by the Big Four automatically enjoy a better reputation, since the investors tend to believe in their financial statements. However, the Big Four take a small portion of the auditing market in Russia. PricewaterhouseCoopers is the only Big Four that ranks in the top four audit firms in Russia (Mennicken, 2010, Table 1). In a country where conservatism and secrecy are in charge, the Big Four that still honors international auditing standards stand for a new force trying to change the Russian system.



In fact, in late 2014, many state-owned companies in oil, insurance, and the banking industry have banned services provided by Foreign Big Four firms, because audits conducted by the Big Four are considered to be western (The Moscow Times, 2014). Most companies prefer to be audited by domestic firms that do not intend to detect corruption as a financial crime. In addition, the Russian government and defense companies have announced banning the “western” Big Four (The Moscow Times, 2014). Russian government and state-owned companies showed evidence that international firms have given away national secrets to foreign countries (The Moscow Times, 2014). The essential reason why companies and government both attack the Big Four, and some other international audit firms, is that both executives and governmental officials do not want details of corruption to be found out.

The fact that the Big Four in Russia cannot take over the majority of the market like they do in China or Japan has to do with the conflict of international standards with Russian social norms, which can be explained by the statutory characteristic of the Russian accounting industry. One corruption test that has been adopted by the Big Four firms is the opportunity test. Auditors observe the environment and answer the question, “What is the probability that the applicable rule, regulation, procedure, instruction or practice could be misused or bypassed in this case to indulge in corruption?” (Khan, 2006). Therefore, the Big Four in Russia, although they do not necessarily stand for higher quality, have made efforts to adhere to international standards and keep their professional audit services in a country that obeys statutory controls.

Another possible answer as to why the Big Four are unwelcome in Russia is that Russian companies simply do not trust foreign firms. It really does not make a difference whether the Big Four issues an unqualified opinion or not. Russian companies simply prefer to do business with

domestic firms. Unlike China, who welcomes international firms so that their companies can march to the global market, in Russia, companies have little motivation to go global.

Germany

As the only western country in this cross-cultural comparison, Germany actually has a set of accounting system values that are quite different from United States. According to S.J. Gray, the characteristics of accounting in Germany are professionalism, uniformity, conservatism, and high-level secrecy (S.J. Gray, 1988). This difference is due to the organizational structure of accounting professionals and the accounting education system.

Auditors in Germany are protected by law to take very limited responsibility in an engagement. Auditors pay up to \$4 million to investors if they issue a wrong opinion (Vieten, 2006). Auditors provide an opinion not as an insurance to investors but to the government. Auditing is a service that “the state wants the profession to perform for society and thus has to regulate in light of the legal monopoly granted to the profession” (Vieten, 2006). Germanic culture does not emphasize individualism as much as Anglo culture does (U.S. or U.K). Therefore, many professionals, including auditors, take the responsibility to ensure the reliability and accuracy of financial statements at a national-level.

The Big Four in Germany controls about 60% of the auditing service market. The market is very concentrated and almost monopolized by the Big Four (Velte, Stiglbauer, 2016, p1). Auditors, *Wirtschaftsprüfer*, differentiates themselves from accountants, because their jobs are highly technical and involve rule-making or development of auditing standards. In the United States, accounting includes auditing, and the two words are often interchangeable. However, in Germany, accountants and auditors are two different professions. The closest translation to accountant is *Buchhalter*, which literally means book-keeper.

The education in Germany also determines that the auditing profession is state controlled rather than self-regulated. Professional auditors in the Big Four have small obligations to investors, because the education they received has taught them to be an auditor as a public servant. Most universities in Germany are public and free. To get into a top university, however, high school students must take “*Hochschulzugangsberechtigung*” – or “university entrance qualification”. Students who prepare to be auditors are usually economics, law, or business administration majors in college and then have additional auditing training, such as going to graduate school, to be qualified to take the certificate exam. Many German auditors have decided to take ACCA certificate in the U.K. which requires a shorter period of training and easier tests. The average age in U.K. to obtain an ACCA certificate is 26/27, while in Germany the number is 31/ 32. (Velte, Stiglbauer, 2016, p1). The Big Four, who have a higher standard in recruiting, are considered to have the best auditing professionals in the country. Therefore, the Big Four in Germany control quality beginning with education quality control.

However, because of the statutory control focus, auditors are not mainly responsible to investors. Knowledge and competency are much more concerned than independence. “Legislation can only exclude an auditor from accepting a mandate in cases where the circumstances cause fear of partiality to arise, but cannot generally guarantee an independent state of mind” (Velte, Stiglbauer, 2016, p1). In the past decade, the German government has relaxed the state-profession boundary and started to let the auditing profession improve and regulate itself. It is not as statutory-controlled as before.

Conclusion

The globalization and localization of the Big Four bring more advantages that outweigh the disadvantages. Advantages include cost savings, the ability to hire local talent that provides

high-quality services, and expanding international influence on developing auditing standards to more developing countries.

First of all, localization is a strategy to save costs. In the late 1980s, the Big Four started to enter the Chinese market through joint venture. However, at that time, the Big Four found an insufficient supply of local accounting talent, so they called thousands of CPAs and partners from U.S. and U.K. to Chinese offices. Compared to today, hiring directly from top Chinese universities saves the Big Four millions of dollars. Hiring employees who speak the native language and know how to do business with local clients is not only convenient but also cost saving due to cultural conflicts that can result in a potential loss. A Japanese auditor who is aware of the importance of the hierarchy will behave in a better manner than an American CPA.

The second benefit is to localize so that the Big Four can hire the best local talent. For example, in Germany, if the Big Four refuses to accept statutory control, they will remain a very independent professional network but they will also lose the opportunity to get closer to the core of the German economy. They will lose the opportunity to hire some of the most talented college students whose ambition is bigger than being an auditor. In May 2012, the Chinese government mandated the Big Four to speed up the localization process. According to Paul Gillis, Big Four in China have successfully localized the low-level staff at the firm but have failed to turn over the higher positions and ownership to the local Chinese. Chinese partners have the knowledge and competency, but because they are influenced by the conservative, secret Chinese culture, they are not trusted. Some former Big Four Chinese partners realize that they are paid much lower than a U.S. partner. It is unfair in a way, but more than fairness, it is the lack of trust and localization. Some Chinese partners leave the Big Four to start their own firms, transfer to the finance industry, or move overseas such as Singapore. Now the demand for experienced Chinese partners

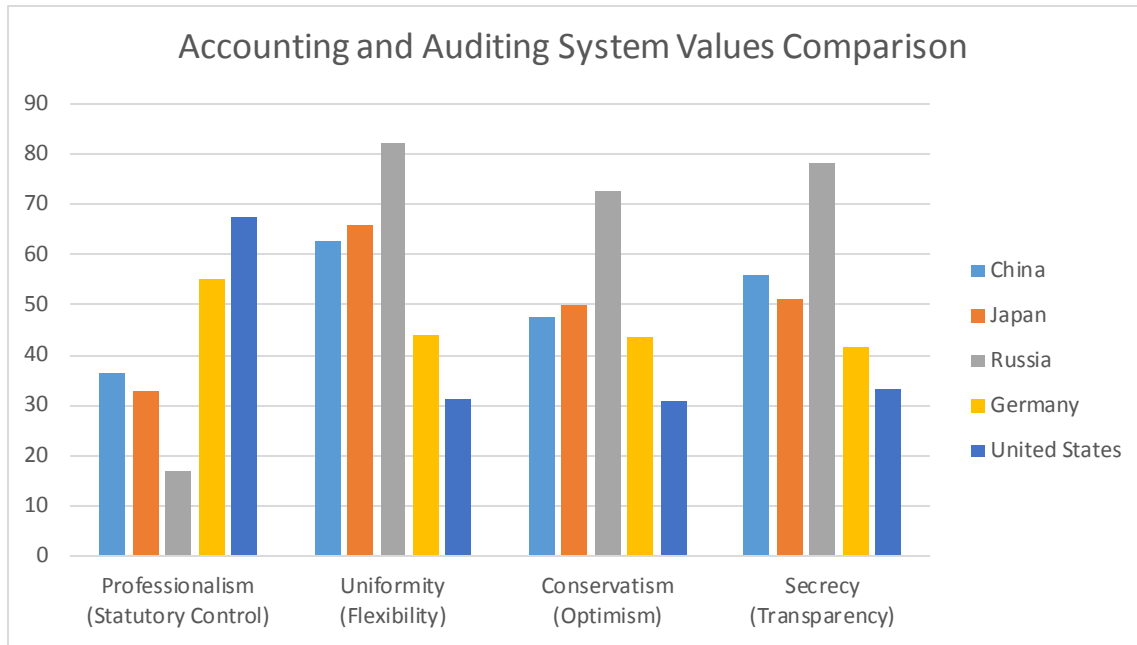
is much higher than the supply. This same situation is happening in Russia with the Big Four.

The Big Four, influenced by Anglo culture, requires that all material financial information be disclosed. This concept is different from what Russian accountants learn at school. They do not see the Big Four as the best work place.

Localization was the strategy when the Big Four first entered a foreign market to gain clients. However, today, companies have the urge and need to adopt to global accounting and auditing standards if they want to go western.

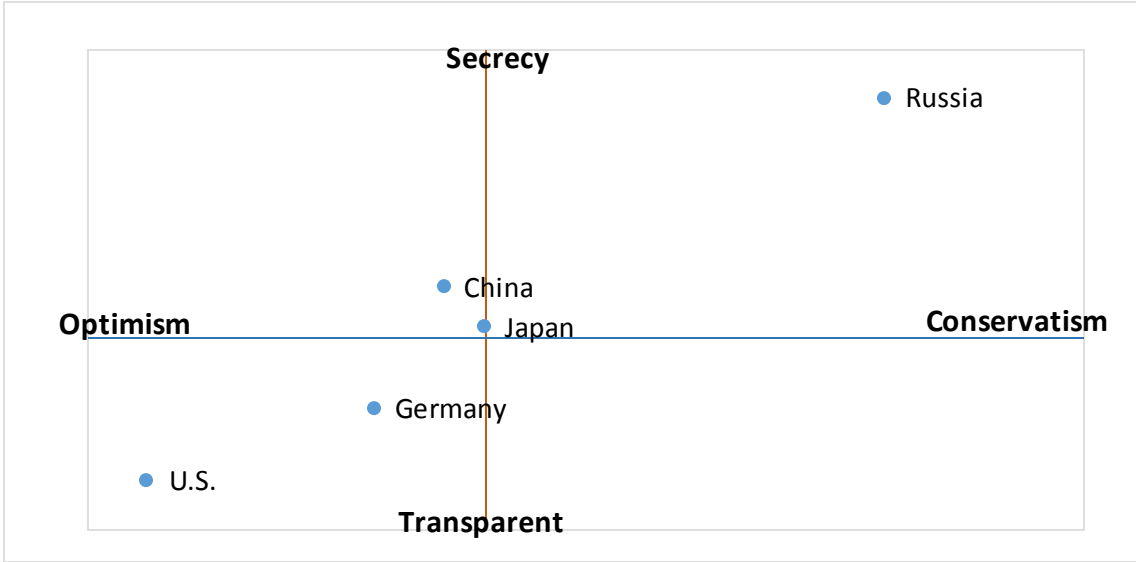
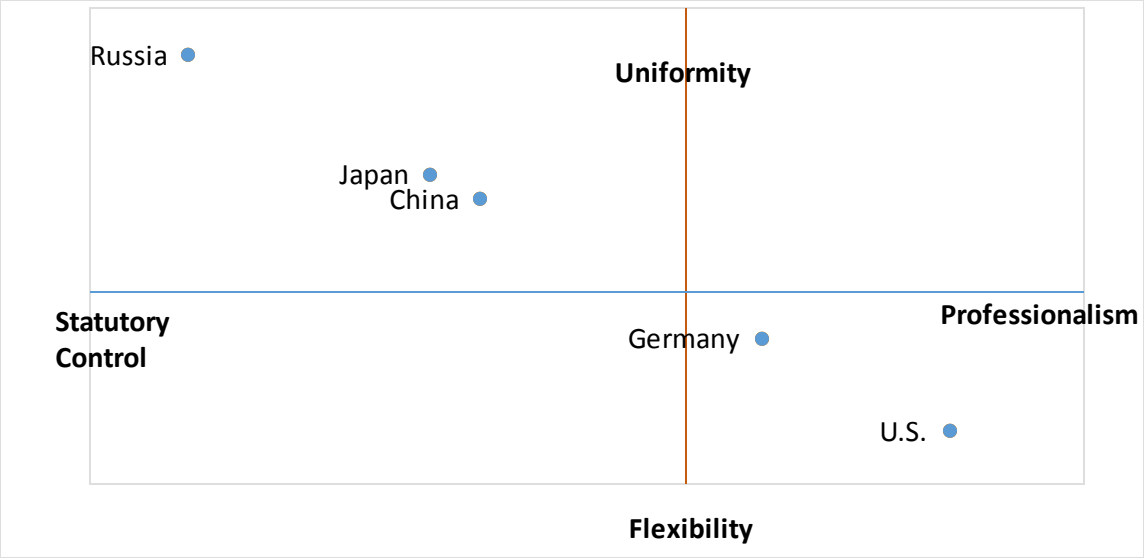
Tables

	China	Japan	Russia	Germany	United States
Power Distance	80	54	93	35	40
Individualism	20	46	39	67	91
Masculinity	66	95	36	66	62
Uncertainty Avoidance	30	92	95	65	46
Long-term Orientation	87	88	81	83	26
Indulgence	24	42	20	40	68
	China	Japan	Russia	Germany	United States
Professionalism (Statutory Control)	36.3	33	16.83	55.11	67.65
Uniformity (Flexibility)	62.7	66	82.17	43.89	31.35
Conservatism (Optimism)	47.52	49.83	72.6	43.56	30.69
Secrecy (Transparency)	56	51.25	78.25	41.75	33.25



	Professionalism	Uniformity	x	y
China	36.3	62.7	-0.41	0.39
Japan	33	66	-0.51	0.50
Russia	16.83	82.17	-1.00	1.00
Germany	55.11	43.89	0.15	-0.19
U.S.	67.65	31.35	0.53	-0.58

	Conservatism	Secrecy	x	y
China	47.52	56	-0.11	0.21
Japan	49.83	51.25	-0.01	0.04
Russia	72.6	78.25	1.00	1.00
Germany	43.56	41.75	-0.28	-0.29
U.S.	30.69	33.25	-0.85	-0.59



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