

Study on the LLP Transformation of Accounting Firms

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Abstract. Since July, 2010, the Chinese government claimed that medium and large-sized firms shall gradually transform from "limited liability system" to "limited liability partnership system". Up to now, almost all firms have completed the restructuring. However, this new system originates from other countries, there may be many unique problems arising in the application process in accounting firms in China. In view of this, this paper combines the current internationalization and strengthening strategy of the firms as proposed by the China Institute of Certified Public Accountants, and analyzes the possible contradictions that confront the firms' strategy of becoming bigger and stronger in the process of the system transforming.

1. Characteristics and evolution process of LLP

1.1. Background and Application of LLP

LLP originates from the United States. Cheng Limin (2012) pointed out that the organizational form of American accounting firms can be clearly divided into three stages. The first stage was at the beginning of the 20th century. The CPA firms in the United States basically adopted a sole proprietorship system or a general partnership system which were with flexibility and strong autonomy. Practice showed that the new system conformed to the economic development situation. Meanwhile, the development of the CPA industry showed that it was the partnership practice at that stage that had built up CPAs and accounting firms, making the CPA industry an intermediary institution with higher credibility.

The second stage begins from the 1960s. A large amount of lawsuits against accounting firms at that time led to high litigation costs and increasing practice risk for CPAs. U.S. experts in the 1990s estimated that because of the sharp increase of legal proceedings and the sum of compensation, the direct accounting expenses of the accounting firms in the United States accounted for 20% of its auditing revenue. As a result, people began to reflect on the general partnership system. In order to seek protection, firms tended to adopt an organization form which was similar to the accounting firm with limited liability, so there were many accounting firms with limited liability system then.

The third stage was in the 1980s. As a result of the weakening of professional level of accounting firms with limited liability, the public's resentment arose. Thus, firms started to try to seek a balance between the limited liability and high-level partnership practice, and LLP came into being. It combines the characteristics of previous partnerships and limited liability. Until now, LLP system has been widely used in professional partnerships firms as accounting firms and law offices in America.



1.2. Development Status of Accounting Firms in China

In recent years, with the rapid development of China's economy, the number of Chinese companies has witnessed a rapid growth, which has driven the demand for accounting firms. As of December 31, 2016, there were approximately 7,600 accounting firms in China's CPA industry, including 3,500 general-partnership accounting firms, 100 LLP accounting firms, and 4,000 limited liability ones. Figure 1 shows the number of accounting firms increased in some years. Table 1 shows the number change of different types of accounting firms in some years.

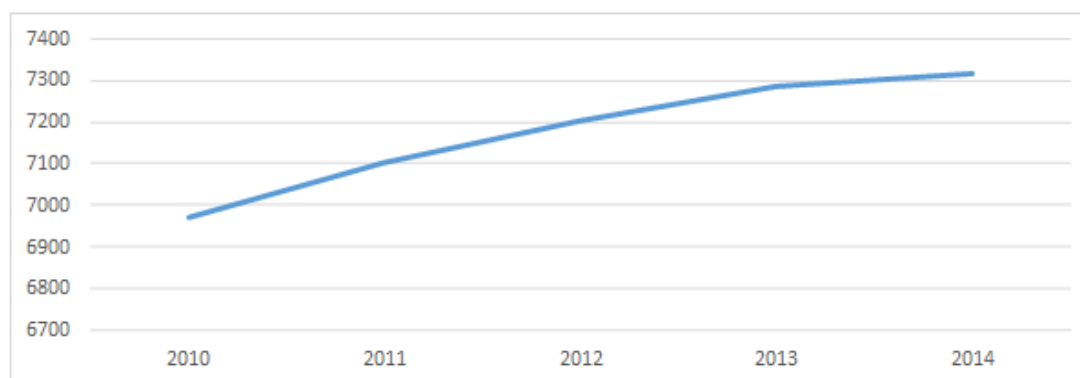


Figure 1. The number of accounting firms increased.

Table 1. The number change of different types of accounting firms.

Types	2010	2011	2012	2013	2014
General-partnership accounting firms	2553	2763	2909	3069	3141
LLP accounting firms	14	24	31	53	50
Limited liability firms	4404	4317	4265	4167	4125
Total	6971	7104	7205	7288	7316

1.3. The development of China's CPA industry and the choice of its organizational form

The CPA industry in China gained a late development because of the social and historical influence. It started from the reform and opening up in 1978, and can be divided into three major development stages. From 1980 to 1991, it was the period of "restoration and reconstruction." At that stage, due to limits of the times, the nature of the CPA profession was not well understood. Most firms were initiated as an affiliate of a higher-level unit. Therefore, organizational forms and institutional settings were simulators of administrative and institutional units. From 1991 to 1998, it was the "standard development stage". During that period, the CPA industry had a further development that the law had specified the work orientation of CPA in 1993, and the "The Law of the People's Republic of China on Certified Public Accountants" was promulgated at that time. During the stage, the accounting firms were still established conforming to the previous affiliation. From 1998 to 2004, it was the "stage of institutional innovation." Major accounting firms completed the delinking and restructuring at that stage and began to take risks themselves, further breaking the constraint of the traditional system. Firms began to adopt a limited liability system and gradually achieved development and growth with this mode which was more advanced. After 2004, accounting firms in China began their internationalization. During this stage, the CICPA required medium and large-sized accounting firms to switch from "limited liability" to LLP through a series of policies and incentives.

As the rising demand that enterprises have toward financial audits, the total revenue of the CPA industry has increased from RMB 31 billion in 2008 to RMB 73.4 billion in 2016, representing a compound annual growth rate of 11.4%. Figure 2 shows the income increase of the CPA industry in some years, and Table 2 shows the average income per partner of the accounting firm gained in some years.

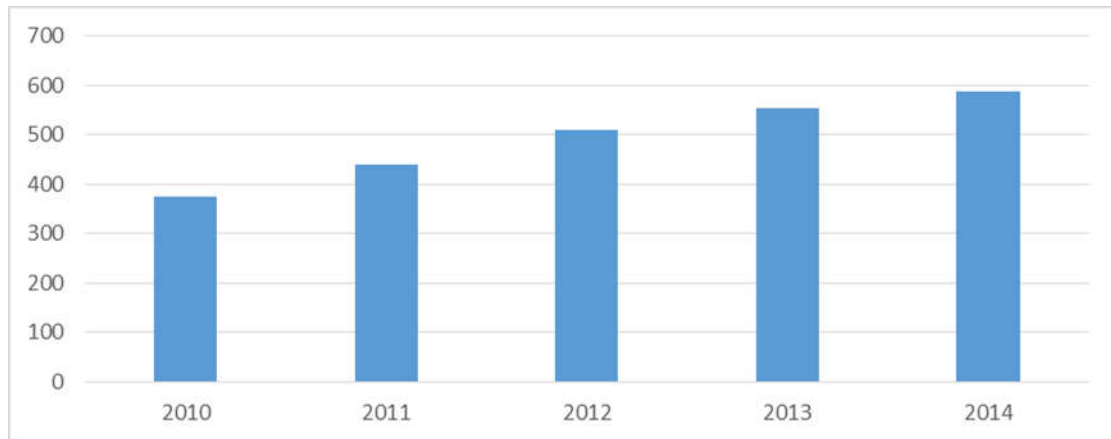


Figure 2. The income increase of the CPA industry.

Table 2. The average income per partner of the accounting firm.

Years	2010	2011	2012	2013	2014
Per capita income	124	144	164	174	186

2. The contradiction of the LLP and the strategy of making the firms bigger and stronger

On September 4, 2011, the CICPA released the "Development Plan for China Certified Public Accountant Industry (2011-2015)" clearly stating that during the "Twelfth Five-Year Plan" period, it would focus on building about 10 accounting firms with international standards on practicing networks, service capabilities, income scale, and market influence. At least three or more firms should enter the world's top 20 in addition to international cooperation agencies. This was a quantitative target for the development of the CPA industry in China. During the international process of accounting firms in China, how can appropriate organizational forms be selected in order to promote the internationalization progress? Luo Junhua, Ye Chengang et al. (2014) pointed out that advancing the LLP system would help our accounting firms reshape the brand of integrity. Cheng Limin (2012) analyzed the changes in the organizational form of the American accounting firms and she pointed out that the limited partnership in the United States and China's LLP system are essentially the same, both of which would promote the development of the firms. However, after careful consideration, we discovered that there are some implicit contradictions between the LLP system and the strategy of building the firms bigger and stronger. Therefore, in-depth and systematic analysis of the contradictions and evolutionary improvements between the two may have a positive impact on the development of the CPA industry in China. Yu Junxian, Ma Ruihua et al. (2013) pointed out that unlike the corporate system which owns a history of hundreds of years, there is not rich experience for LLP system to learn from. Therefore, in the implementation process, we must pay attention to preventing risks and further exploring the way. The contradictions between the LLP system and the firm's strategy of becoming bigger and stronger are as follows:

2.1. The "human jointing" feature of LLP system will limit the rapid development of the firm to some extent.

Zheng Yang (2013) pointed out that the limited number of shareholders of limited liability companies constrains the willingness of firms to build them bigger and stronger, and to a large extent restricts the objective requirements for the growth of firm personnel. LLP system can very well avoid the number limit of the shareholder. However, after the general partnership system being established, it is apparently necessary to absorb a sufficient number of partners in order to make the firm bigger and stronger, and it is noted that even if the LLP system introduces "limited liability" on the basis of the partnership system, its nature is to emphasize human jointing based on the partnership. In view of this,

it will be not very easy for one or more accounting firms with LLP system to introduce new partners, because each partner may have different views on new partners. At this time, consultation, coordination, etc. will waste a lot of time, which will slow down the speed of the firm's growth. Luo Junhua and Ye Chengang et al. (2014) pointed out that LLP system requires partners to be comprehensive personnel who understand the enterprises and talents management. Obviously, such talents in China are limited, which limits the partner introduction of general partnership firms from the other side. Therefore, the LLP system seems to have cleared the restrictions on the number of shareholders in the limited liability firms, which is conducive to build the firms bigger and stronger, but it also brought new problems, which also restricted the firm's development.

2.2. LLP firms will be less competitive than limited liability firms in a short term

During the transformation from limited liability companies to LLP firms, the accounting firms have been facing an increasing risk of legal proceedings and compensation liability. Therefore, it will be more cautious when choosing to maintain customer relationships, undertake specific business, as well as the operation during the practice process. Obviously, the cost will increase a lot. Limited liability companies can save auditing costs to a certain extent due to their low risk. The auditing market in China is a typical buyer's market. The bargaining power of the LLP firms is much lower than that of the limited liability firms. Therefore, the short-term competition of the LLP firms will be less than that of limited liability firms will diminish in a short period of time.

2.3. LLP system may confuse the property rights in the firm and limit the firm's ability to become bigger and stronger

Li Xinfang (2014) emphasized that the property rights of a LLP accounting firm own features of joint occupation, joint use, the free choice of sharing the revenue and no disposing right. Partners in LLP accounting firms only have the right to share the revenue but don't have the disposing right. This may trigger short-sighted behavior of partners in the firms that some partners may only care about their own short-term interests and ignore the development plan of the firm in the future, which will hinder the implementation of the strategy of building these firms better to a certain extent. The confusion of property rights caused by the LLP system will also aggravate the partner's interest conflict. In decision-making, the LLP system firms adopt the mode of "one person, one vote", which seems to be democratic, but because different partners have different preferences for risk, whether or not a business firm undertakes or is strict about the establishment of firm quality control system will result in a conflict of interest.

2.4. Non-certification business development of LLP accounting firms may be slowed down in the initial period of transformation

Zeithaml and Bitner (1996) pointed out that the overseas consulting income of four of the six largest international accounting firms (the six major firms in 1996) had exceeded half of their total revenue, which shows that the firm's non-certification business is the fields that must be valued in the firm's overall development process. Through empirical research and questionnaire surveys, Tang Juanjuan (2013) studied the relationship between non-auditing services and the independence of auditing services. She found that the correlation between non-audit services providing and the independence is not significant, and then pointed out that it is necessary for China to continue to promote the development of non-auditing services offered by accounting firms both from the perspective of the market and the accounting firms. We may have noticed that when foreign firms adopted the limited liability partnership system, non-certification business developed well, so it is feasible for accounting firms in China to adopt LLP system. However, we ignored that most of the accounting firms in China have just developed from the limited liability system with a short development period and without a strong sense of partnership.

3. Conclusion

The transformation to LLP accounting firms in China is in line with the requirements of reform and opening up in the new era and the only way to adapt to international development. However, LLP system is an organization form originating from Western countries, and there will inevitably be many problems in the process of practice. Therefore, we cannot blindly copy it, but to constantly adjust and optimize it in accordance with our national conditions and situational requirements, and only in this way, can the development of China's accounting firm industry be promoted.

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