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Issues Affecting Convergence of Chinese Accounting Standards with IFRS

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ABBREVIATIONS AND ACRONYMS

ASBE	Accounting Standards for Business Enterprises
ASC	Accounting Society of China
CASC	China Accounting Standards Commission
CBRC	China Banking Regulatory Commission
CEO	Chief Executive Officer
CFO	Chief Financial Officer
CICPA	Chinese Institute of Certified Public Accountants
CIRC	China Insurance Regulatory Commission
CPA	Certified Public Accountant
CPC	Communist Party of China
CSRC	China Securities Regulatory Commission
EC	European Commission
EU	European Union
FASB	Financial Accounting Standards Board
FDI	Foreign Direct Investment
FV	Fair Value
FY	Fiscal Year
GAAP	Generally Accepted Accounting Principles
GDP	Gross Domestic Product
G20	Group of Twenty
IAS	International Accounting Standards
IASB	International Accounting Standards Board
IASC	International Accounting Standards Committee
ICAS	Institute of Chartered Accountants of Scotland
IFRS	International Financial Reporting Standards
IPO	Initial Public Offering
MOF	Ministry of Finance
MoU	Memorandum of Understanding
NAI	National Accounting Institute
QFII	Qualified Foreign Institutional Investor
RMB	Renminbi
SAFE	State Administration of Foreign Exchange
SASAC	State-owned Assets Supervision and Administration Commission
SAT	State Administration of Taxation
SEC	Securities and Exchange Commission
SOE	State-owned Enterprise
U.S.	United States
USD	U.S. Dollar
WTO	World Trade Organization

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Chapter 1

Introduction

The increasing globalization of capital markets and the significant growth of multinational enterprises created demand for a single set of global accounting standards to improve the comparability and transparency of financial reporting worldwide (Barth and Schipper, 2008). Enhancing the comparability in financial reporting has been expected to promote capital flow across countries, including foreign direct investment (FDI) (Doupnik and Perera, 2012; Brüggemann *et al.*, 2013). To reduce differences in financial reporting across countries, the International Accounting Standards Board (IASB) has been working on developing a single set of high-quality financial reporting standards, known as International Financial Reporting Standards (IFRS), and promoting worldwide adoption of IFRS. The IASB's survey[1] shows either mandatory or voluntary adoption of IFRS[2] in about 130 countries (as of August 30, 2016).

IFRS reflect the Anglo-American accounting model, which, in a broad sense, refers to the accounting system widely used in English-speaking countries such as the United Kingdom and the United States (Doupnik and Perera, 2012). The Anglo-American accounting model focuses on investor-orientation, extensive application of fair value accounting and accountants' professional judgments (Hellmann *et al.*, 2010). Furthermore, this model has been developed over a long period of time in an environment characterized by developed capital markets, common law, and the separation of accounting and income tax scheme (Hail *et al.*, 2010b; Doupnik and Perera, 2012; Nobes and Parker, 2012). The IASB's promotion of IFRS adoption implied that Anglo-American accounting values, practices, and principles are superior to national accounting standards, and IFRS can be applied consistently in all countries (Ball, 2006; Hellmann *et al.*, 2010).

However, numerous studies documented that accounting standards and practices are deeply embedded in each country's context, including its cultural, legal, organizational, political, and economic environments (Doupnik and Richter, 2003, 2004; Doupnik and Riccio, 2006;

Hellmann *et al.*, 2010; Chand *et al.*, 2010; Chand, 2012; Perera *et al.*, 2012; Nobes and Parker, 2012; Drnevich and Stuebs, 2013). These previous studies also revealed that contextual factors lead to inconsistent interpretations and applications of IFRS across countries. Thus, it is necessary to clarify contextual factors and their effects on convergence with or adoption of IFRS in individual countries (Hail *et al.*, 2010a, 2010b; Brüggemann *et al.*, 2013). Brüggemann *et al.* (2013) argued that "focusing on more specific settings (e.g. a single country or trading segment) is likely to help researchers understand and control for contemporaneous non-IFRS effects" (Brüggemann *et al.*, 2013, p.22).

This study focuses on the convergence[3] with IFRS between 2006 and 2015 in China, when the Chinese government made great reforms to globalize its accounting system and surrounding institutions. The accounting standards setter in China, the Ministry of Finance (MOF) took a big step toward the global convergence of IFRS by establishing a new set of Chinese GAAP in 2006, which was acknowledged by the IASB as having achieved "substantial convergence"[4] with IFRS (IASB, 2006). The MOF required all listed companies in China's domestic capital markets to apply the new set of Chinese GAAP for both consolidated and non-consolidated financial statements from the beginning of the fiscal year 2007. The MOF afterwards has been gradually extending the application of the new set of Chinese GAAP for consolidated and non-consolidated financial statements of unlisted large and medium-sized companies.[5] By promoting the application of the new set of Chinese GAAP in all Chinese listed companies and all unlisted large and medium-sized companies, the MOF aims to avoid applying multiple sets of accounting standards in these enterprises, and improve the comparability and the quality of financial reporting in Chinese enterprises (MOF, 2009a).

Since 2011, the current Chairman of the IASB, Hans Hoogervorst, has pressured the MOF to fully adopt IFRS to replace Chinese GAAP. For example, when he visited to China in 2011, he gave a speech and stated:

> *…there is a lingering suspicion among the broader international financial reporting community about closeness between IFRS and Chinese*

> *accounting standards. In this regard, the term 'principally in line with IFRS' does China no favours. It is for this very reason that Brazil, another country that is on the verge of fulfilling its full economic potential, has decided to fully adopt IFRS. In its strategy to become the leading regional financial marketplace, Brazil knew it needed the full benefits of the IFRS franchise. Investors in London, New York, Paris, Frankfurt, and Shanghai all understand when a Brazilian company's financial statements are labelled 'in conformity with IFRS'* (Hoogervorst, 2011a).

The MOF, however, has no plans to accept the "direct adoption approach" (either mandatory or voluntary) suggested by the IASB, in which IFRS would replace Chinese GAAP. Instead, the MOF applies the so-called "convergence approach", under which it continues to develop Chinese GAAP while it gradually eliminates disparities between Chinese GAAP and IFRS over time. In regard to reasons for applying the convergence approach rather than the direct adoption approach, Yang Min, former Director General (2010-2015) of the Accounting Regulatory Department[6] within the MOF, stated:

> *Considering the Chinese legal environment, codes of language, practical problem solving, implementation of accounting standards, and grasping the initiative and flexibility [of accounting standards setting by the MOF] (added by the author) in the trend of accounting globalization, adhering to the convergence approach is a pragmatic and effective way to meet the needs for establishing and developing accounting standards [in China]* (Yang *et al*., 2011, p. 14).

As suggested by former Director General Yang Min, the MOF's decision regarding convergence with IFRS is based primarily on considerations of the Chinese contextual factors, which are quite different from those in Anglo-American countries. In the debate about the most suitable solution regarding IFRS implementation in China, it is an urgent issue to examine the main features of Chinese-specific contextual factors and their effects on the convergence of Chinese GAAP with IFRS.

Several studies have addressed issues concerning Chinese accounting system and identified substantial differences between Chinese GAAP and IFRS, such as different accounting treatments for business combinations under common control[7] and the limited application of fair value measurement in Chinese GAAP (Biondi and Zhang, 2007; Peng and Bewley, 2010; Baker *et al*., 2010). Furthermore, these related previous studies clarified several Chinese-specific contextual factors, and illustrated their impacts on the accounting system in China, such as the influence of political ideology on the adoption of conservatism principle in Chinese GAAP (Ezzamel *et al.*, 2007) and the impact of organizational structure and industrial development on the Chinese accounting for business combinations (Biondi and Zhang, 2007; Baker *et al.*, 2010). However, the relevant studies provided a unidimensional rather than integrated and holistic view of the Chinese-specific context in which accounting operates. Gernon and Wallace (1995) described the context related with accounting as national accounting environment and argued that the accounting environment in a country is a complex multidimensional system, including societal, organizational, professional, individual and accounting elements. These elements are interactive with each other and no one element occupies a predominant position.

The objective of this study is to conduct a holistic and rigorous analysis of the main features of the accounting environment in China by invoking the accounting ecology framework developed by Gernon and Wallace (1995). Specifically, this study investigates the Chinese accounting environment over the period from 2006 to 2015, when China made significant reforms to accelerate the globalization of its accounting and related systems. The scope of Chinese companies to be examined in this study is all large and medium-sized companies, including publicly traded companies with their shares listed in Chinese and/or overseas capital markets and unlisted companies. This scope is consistent with the MOF's intention of promoting all large and medium-sized Chinese companies to prepare their consolidated and non-consolidated financial statements in accordance with the new set of Chinese GAAP.

Gernon and Wallace (1995) described an accounting ecology within a country, which comprises five individual but interactive components: (1) societal environment, including structural, demographic and cultural variables that may affect the demand for financial accounting services; (2) organizational environment, referring to such variables as organizational size, technology and complexity, and human and capital resources, which are relevant to rationalizations in the choice and design of accounting systems; (3) professional environment, including variables related to the accounting profession, such as the education, training, registration, discipline, professional ethics and culture of accountants and auditors; (4) individual environment, covering the accounting policy choices and actions of individuals such as professional bodies and regulators; (5) accounting environment, encompassing financial reporting rules and practices, influenced by and proactively affecting variables in the other environments (Gernon and Wallace, 1995, p.60). By invoking the accounting ecology framework developed by Gernon and Wallace (1995), this study clarified not only technical aspects of accounting, such as the classification, valuation and measurement requirements, but also the effects of contextual factors on accounting practices in China.

This study' research design is a case study approach. Cooper and Morgan (2008) suggested that the case study approach is useful when the research aims to examine the details of context-dependent, complex and significant events, such as the changes in accounting regulations, and helpful for understanding the applicability and rationalization of certain accounting regulations in a specific context. By analyzing archival materials, this study clarified the main features of the Chinese-specific context between 2006 and 2015 in which the convergence of Chinese GAAP and IFRS proceeded, and investigated the effects of contextual factors on the applicability and rationalization of IFRS in contemporary Chinese accounting environment.

Findings of this study show that certain characteristics of the Chinese accounting environment promoted the convergence of Chinese GAAP with IFRS. For example, the integration of Chinese economy and capital markets into the global systems created the demand for the globalization of Chinese accounting system. Specifically, increase of FDI in China and Chinese companies' financing in overseas capital markets highlighted the importance of high-quality financial reporting to meet the information needs of foreign investors.

While at the same time, findings of this study show that certain features of the Chinese accounting environment may hinder the direct adoption of IFRS in China. For example, although an increasing number of Chinese enterprises have raised or plan to raise funds in overseas capital markets, most Chinese companies conduct fund-raising only in domestic capital and credit markets. This may lead to a relatively passive demand for adopting IFRS in China and provide a rationale for the MOF's decision to apply the convergence approach rather than the direct adoption approach (either mandatory or voluntary).

Furthermore, findings of this study show that in the current Chinese context, there is a lack of the necessary infrastructure to support consistent interpretations and applications of IFRS. Particularly, while IFRS rely on a more principles-based approach (Ball, 2006), Chinese accounting professionals are accustomed to rules-based accounting standards (Chen, 2007). This suggests that the necessary trainings and experience to implement more principles-based IFRS are urgent issues in China. Through these investigations, this study suggests that changing accounting standards (e.g. adopting IFRS) without considering the institutional complementarities between accounting rules and surrounding infrastructures potentially leads to undesirable outcomes for the country as a whole, such as an increase in implementation costs of accounting standards and a decline in the reliability of financial information, even if the change is intended to improve financial reporting.

This study contributes to a deeper understanding of the financial reporting convergence in China by providing a holistic perspective to appreciate the contextual factors such as economic development, organizational structure, education and training of accounting professionals and lobbying activities, which affect the accounting standards and practices in a specific country. This would contribute to evaluate what accounting standards are practical and rational or vice versa in Chinese-specific context. This study challenges the uncritical adoption of IFRS, which has ignored, to a great extent, the effects of the accounting environment and the "possible, probable and desirable accounting practices" (Gernon and Wallace, 1995, p.74) in individual countries.

China's experience is of particular interest for several reasons. First, China is in transition from a centrally-planned economy to a market-oriented economy and has a different context from Anglo-American countries. Chinese-specific context includes some essential features such as extensive state ownership of business firms, underdeveloped capital markets, and a deficiency in qualified accounting professionals. Thus, China provides an appropriate context to investigate the applicability and rationalization of IFRS in a certain country.

Second, while China has a distinguishing context, it shares many characteristics with other emerging market-oriented economies, such as a desire to attract foreign capital, efforts to foster credible accounting professionals, and a need for high-quality financial reporting to facilitate the infrastructure necessary for efficient capital markets. Countries with emerging market-oriented economies anticipate that the adoption of IFRS will improve the transparency and comparability in financial reporting of domestic enterprises, promote the development of efficient domestic capital markets, and facilitate the development of national economies (Jaruga *et al*., 2007; Albu and Albu, 2012). However, there is a concern that IFRS may not be applied consistently in emerging market-oriented economies. For example, because countries with emerging market-oriented economies generally lack well-developed markets, it is difficult to get active market prices to implement the mark-to-market measurements of fair values. Investigation of the IFRS implementation in countries with emerging market-oriented economies is valuable as it may contribute to international accounting researches and public policy making (Carmona and Trombetta, 2008). This study can provide insights into the reaction of China to IFRS adoption and the constraints imposed by the Chinese accounting environment on IFRS implementation. These insights are also relevant for other countries with emerging market-oriented economies.

Third, as the largest emerging economy, China has increasing impacts on global economic and political issues such as the global convergence of financial reporting. Particularly, Chinese stakeholders, such as the China Securities Regulatory Commission (CSRC), the MOF, accounting academics and State-owned enterprises (SOE) have been playing an increasing role in the process of establishing and interpreting IFRS.

Zhang Weiguo was appointed as one IASB member in 2007 with a five-year term, which was renewed in 2012 and extended to June 30, 2017. Before the appointment, he worked as the Chief Accountant and Direct General of the Department of International Affairs within the CSRC, and was involved in the issues regarding the establishment and the implementation of Chinese accounting standards.

Additionally, since 2006, successive Director Generals of the Accounting Regulatory Department within the MOF, Wang Jun, Liu Yuting, Yang Min and Gao Yibin were appointed as IFRS Advisory Council members with the term of service from January 1, 2006 to December 31, 2008, from January 1, 2009 to December 31, 2011, from January 1, 2012 to December 31, 2015, and from January 1, 2016 to December 31, 2018, respectively. Huang Shizhong, Vice President of the Xiamen National Accounting Institute (NAI) were appointed as one IFRS Advisory Council member with the first term of service from January 1, 2012 to December 31, 2014, and the second term of service from January 1, 2015 to December 31, 2017. The IFRS Advisory Council is the formal advisory body to the IASB and the Trustees of the IFRS Foundation and provides consultations and advice to the IASB on issues, such as project priorities and possible benefits and costs of particular proposals.

Moreover, the Vice Presidents and Chief Financial Officers of two Chinese SOEs, the China Oilfield Services Company and the China Life Insurance Company, Li Fenglong and Yang Zheng were successively appointed as members of the IFRS Interpretations Committee with the term of service from July 1, 2010 to June 30, 2016, and from July 1, 2016 to June 30, 2019, respectively. The IFRS Interpretations Committee is responsible for reviewing on implementation issues of existing IFRS and providing authoritative guidance on those issues.

The MOF expects:

> *The full participation of Chinese representatives into the international [accounting] standards setting organization would help [Chinese shareholders] to timely present Chinese-specific accounting issues to the IASB and force [the IASB] to fully take account of China's actual situations and needs during the process of revising and refining major IFRS projects, thereby improving IFRS's acceptance, authority and operability, especially its applicability in emerging market economies* (MOF, 2010a).

This study would provide useful understandings of major Chinese stakeholders such as the MOF and the CSRC's considerations for Chinese-specific context and their perceptions of IFRS adoption (either mandatory or voluntary) in China. Given that China has been pursuing growing influence on the global convergence of financial reporting, the understandings offered by this study would be important and unignorable for the IASB, which aims to develop and promote a single set of global accounting standards.

The remainder of this study is organized as follows. Chapter 2 summarizes the convergence process of Chinese GAAP with IFRS between 2006 and 2015. Chapter 3 discusses the related prior literature and explicates the research motivation and objective. Chapter 4 describes the research methods of this study, by elaborating the contextual perspective, the case study approach, the theoretical framework and the data collection. Chapter 5 applies the theoretical framework to clarify the primary features of the Chinese accounting environment, from societal, organizational, professional, individual, and accounting aspects. Chapter 6 investigates other factors that are likely to impede the IFRS implementation in China. Chapter 7 concludes this study by summarizing China's accounting environment and its impacts on the convergence of Chinese GAAP with IFRS.

Chapter 2

The Convergence Process of Chinese GAAP with IFRS

2.1 Substantial Convergence Stage (2006-2010)

The convergence towards or adoption of IFRS at a global level had put China under strong external pressures to converge its accounting system with IFRS and triggered the accounting reforms in China since 2005. The endeavors of the International Accounting Standards Committee (IASC) to establish a set of core standards during 1990s and the efforts of its successor, the IASB, to improve the core accounting standards had succeeded in earning the respect and support of national accounting standard setters, regulators in the major capital markets, as well as the preparers and users of financial statements around the world (Zeff, 2012).

The European Commission (EC) proposed that all European Union (EU) companies listed on the regulated capital market should prepare their consolidated financial statements in accordance with International Accounting Standards (IAS) at least from 2005 in the *EU Financial Reporting Strategy: The Way Forward* issued in June 2000 and stated that "already IAS provides a comprehensive and conceptually robust set of standards for financial reporting that should serve the needs of the international business community" (EC, 2000, para.15). The European Parliament and the Council of the EU, in July 2002, issued the EU Regulation No. 1606/2002, in which the proposal of the EC in June 2000 was officially approved, and the effective date was set as January 1, 2005 (European Parliament and Council of the EU, 2002). As such, IFRS got a large amount of users (the EC, in June 2000, estimated the number of companies that would be required to prepare consolidated financial statements in accordance with IAS would be around 6,700) in one of the most important capital markets. This promoted the acceptance of IFRS as one single set of global accounting standards.

Other national accounting standards setters took much notice of the EU's strategy towards IFRS. After the endorsement of mandatory adoption of IFRS in the EU, many jurisdictions such as Australia, Hong Kong, and South Africa, accelerated the convergence of national accounting standards with IFRS or adopted IFRS as national accounting standards (Camfferman and Zeff, 2015).

The IASB and the Financial Accounting Standards Board (FASB), in October 2002, issued a Memorandum of Understanding (MoU), known as "The Norwalk Agreement", in which the two most influential accounting standards setters committed to mutually converge IFRS and the U.S. GAAP "as soon as practicable" (FASB and IASB, 2002). Afterwards, the Chief Accountant of the Securities and Exchange Commission (SEC), Don Nicolaisen, in 2005, published an article titled *A Securities Regulator Looks at Convergence*, in which he proposed a possible roadmap for eliminating the SEC's requirement that foreign private issuers should reconcile financial statements prepared under IFRS to U.S. GAAP (Nicolaisen, 2005). The SEC, in November 2007, approved the proposal and allowed foreign private issuers, which register securities with the SEC, to prepare their financial statements in accordance with IFRS as issued by the IASB without reconciliation to U.S. GAAP, for fiscal years after November 15, 2007 (SEC, 2007). These movements showed that IFRS had been getting the support from the regulator of the biggest and most influential capital markets, namely the U.S. capital markets. The support of SEC towards convergence of U.S. GAAP and IFRS had broaden the awareness and attention given to IFRS, consequently, the global convergence towards and adoption of IFRS gained further momentum.

After the restructuring of the IASC into the IASB, which aimed to promote the rigorous application of IFRS around the world, the IASB began to seek the acceptance of IFRS in China (Graham *et al*., 2013). For example, Sir David Tweedie, the former Chairman (2001-2011) of the IASB, had visited China for five times to explore the adoption of IFRS in China from 2002 to 2004 (Feng and Ying, 2005). The MOF, however, appeared to have a hesitation about converging Chinese GAAP and IFRS between 2001 and 2004. Actually, Feng Shuping, former Director General of the Accounting Regulatory Department within the MOF (1996-2001) and former Assistant Minister of the MOF (2001-2004), was responsible for the accounting standards setting in China during the period from 2001 to

2004. Feng Shuping was extremely cautious of the global convergence of accounting standards. For example, Feng Shuping, in 2001, stated:

> *It can be expected that international accounting standards will reflect more the characteristics and contents of the accounting standards in the United Kingdom and the United States ... During the globalization process of Chinese accounting standards, the unilateral convergence towards U.S. GAAP or IAS would require Chinese enterprises to spend high costs to prepare financial statements in line with the requirements of U.S. GAAP or IAS, and require Chinese users of financial reporting to spend considerable costs to learn [new accounting standards] in order to understand the accounting information. ... Although pursuing the unilateral convergence towards U.S. GAAP or IAS will reduce, to an extent, Chinese enterprises' costs of foreign financing and foreign trade, reform costs and risks accompanied by the convergence would be significant, about which we should have a full understanding* (Feng, 2001).

While Feng Shuping, at the beginning, emphasized the costs and risks accompanied by the convergence, she gradually turned to a more positive attitude towards the global convergence of accounting standards along with the global trend of convergence during the period from 2001 to 2004, in which an increasing number of countries required or permitted domestic companies to prepare financial statements in accordance with IFRS. Feng Shuping, with the co-author, Ying Wei, who was an official within the MOF, published an article titled *The Establishment of Chinese Accounting Standards and the Global Convergence* in the January 2005 issue of the *Accounting Research*. This article can be considered as a policy proposal.[8] In the article, Feng Shuping and Ying Wei argued that with the economic globalization and Chinese economy's dependency on foreign trade and financing, convergence of Chinese GAAP with IFRS is inevitable for China (Feng and Ying, 2005).

Feng Shuping, however, did not changed her opinion that China should not directly adopt IFRS (she mentioned this opinion as "unilateral convergence towards IAS" in previous statements), and should not give up establishing Chinese GAAP (Feng and Ying, 2005). Furthermore, Feng Shuping reaffirmed the consensus within the MOF regarding the strategy toward the convergence of Chinese GAAP with IFRS. The strategy suggests classifying economic transactions and events into four categories and applying different convergence approaches as follows:

(1) Where economic transactions are identical to those regulated by IFRS and so are the environments in which these transactions proceed, Chinese GAAP should adopt the accounting treatments same with IFRS;
(2) Where the forms of economic transactions are identical to those regulated by IFRS but due to the special environments in China, the economic substance is not exactly the same, China should not duplicate IFRS principles, but should establish Chinese-specific standards based on the transactions' economic substance;
(3) Where economic transactions regulated by IFRS are prevalent in countries with developed market-oriented economies, but not common in China, China should firstly carry out researches of these transactions, and then adopt IFRS until such transactions become more common in China;
(4) Where economic transactions are specific to China due to the underdeveloped market-oriented economy, China needs to develop Chinese-specific accounting standards or rules to regulate the accounting treatments of these transactions, even corresponding regulations in IFRS do not exist (Feng, 2004; Feng and Ying, 2005).

The strategy advocated by Feng Shuping has been held on by successive officials within the MOF who were/are responsible for accounting standards setting in China.

Feng Shuping, in December 2004, was replaced by Wang Jun, former Director General of the Accounting Regulatory Department within the MOF (2004-2005) and former Vice Minister of the MOF (2005-2013). Wang Jun focused more on the benefits of converging Chinese GAAP with IFRS. For example, Wang Jun argued that the convergence of Chinese

GAAP with IFRS would improve "the quality and transparency" of Chinese enterprises' financial reporting, thus, would better meet stakeholders' needs for accounting information, such as the needs of investors, creditors, regulators and managers in enterprises (Wang, J., 2005, pp.4-5).

Wang Jun accelerated the convergence of Chinese GAAP with IFRS. Under the impetus of Wang Jun, the MOF, at the beginning of 2005, set up a plan to establish 22 new specific accounting standards and to revise the existing basic accounting standard and 16 specific accounting standards until the end of 2005 or the beginning of 2006 (Wang, J., 2005). In order to establish a new set of Chinese GAAP in line with IFRS, Wang Jun boosted the collaboration between the MOF and the IASB. As a result, the IASB offered the MOF technical assistance and sent an expert group to China in October 2005, in order to solve technical issues of the convergence of Chinese GAAP with IFRS (Liu, 2008).

The collaboration between the IASB and the MOF resulted into a joint statement, mentioned as the "2005 Beijing Joint Statement", in November 2005, in which the MOF announced that it sets the convergence with rather than adoption of IFRS as "one of the fundamental goals of" its standard-setting programme (CASC and IASB, 2005). The IASB, in turn, took a step back from its initial strong position that convergence means full adoption of IFRS word for word (Wang, 2006b), and recognized that the MOF has the authority to determine the form and ways to converge Chinese GAAP with IFRS (CASC and IASB, 2005). Furthermore, the IASB identified that a number of accounting issues, including disclosure of related party transactions, fair value measurement and business combinations under common control, are specific for China because of Chinese "unique circumstances and environment" (CASC and IASB, 2005).

Several months after this joint statement, the MOF promulgated a new set of Chinese GAAP in February 2006, known as the *Accounting Standards for Business Enterprises* (ASBE). The IASB and the MOF acknowledged that a few differences still existed between the new set of Chinese GAAP and IFRS, however, these differences would not lead to different outcomes in terms of accounting numbers in the financial statements (Liu, 2007). The differences are as follows:

(1) Chinese GAAP required the pooling of interest method for business combinations involving entities under common control and the purchase method for business combinations involving entities not under common control, while IFRS only provided the regulation for the accounting treatment of the latter case, but provided no regulation for the former case. Liu Yuting, former Director General (2002-2010) of the Accounting Regulatory Department, explained this difference and stated:

> *Because of Chinese special economic environment, some business combinations involve entities under common control. If we do not establish accounting regulation for these transactions, there will be a gap, which would lead to ruleless accounting practices. Thus, according to Chinese actual situations, we regulated the accounting treatment for business combinations under common control. The IASB acknowledged that Chinese accounting standards and practices for business combinations under common control would offer useful reference to the establishment of international accounting standards* (Liu, 2007, p.6).

(2) While IFRS required the extensive application of fair value to improve the relevance of accounting information, Chinese GAAP emphasized moderate and cautious application of fair value. Liu Yuting explained this difference as following:

> *[The MOF] mainly considered that as an emerging market-oriented economy, active markets for many assets are absent in China. There is no doubt that the relevance of accounting information is important, but relevance should be premised on reliability. If [the MOF] adopts fair value measurement without constraints, earnings manipulations are likely to occur. Thus, Chinese GAAP, such as accounting standards for investment properties, biological assets, non-monetary assets exchanges, debt restructuring, regulated that only when active markets exist and fair values*

can be obtained and reliably measured, fair value measurement is allowed (Liu, 2007, p.6).

(3) Chinese GAAP did not include a separate accounting standard to regulate non-current assets held for sale and discontinued operations, but provided regulations similar to IFRS 5 in several accounting standards such as the ones for fixed assets, long-term equity investment and presentation of financial statements, guidelines (*yingyongzhinan*), interpretations (*jieshi*), and explications (*jiangjie*). Liu Yuting explained that "Chinese GAAP would result into similar accounting treatments [as IFRS do] regarding non-current assets held for sale and discontinued operations" (Liu, 2007, p.7). For example, the MOF, in 2007, issued Interpretation No. 1 and required Chinese enterprises to measure non-current assets held for sale at the lower of carrying amount and fair value less costs to sell (MOF, 2007b). This measure attribute is same with IFRS. Regarding the accounting regulations of non-current assets held for sale and discontinued operations, Liu Yuting stated that "the IASB agrees with the MOF's approach" (Liu, 2007, p.7).

(4) While IAS 19 and IAS 26 regulated post-employment benefit plans, including defined benefit plans and defined contribution plans, Chinese GAAP did not include such regulations. Liu Yuting explained the reason and stated "there are no regulations concerning post-employment benefit plans in current Chinese laws" (Liu, 2007, p.7), and post-employment benefit plans were almost non-existent in China. The IASB acknowledged that this difference would not hinder the convergence of Chinese GAAP with IFRS (Liu, 2007).

(5) While IAS 29 regulated the financial reporting in hyperinflationary economies, Chinese GAAP did not include such regulation. Liu Yuting explained the reason as "We consider that because Chinese market-oriented economy is under the macroscopical control [of the Chinese government], it is expected that hyperinflation will not happen in China. Thus, there is no need for the relevant accounting standard" (Liu, 2007, p.7). Liu Yuting also stated that "the IASB totally agreed with us that China does not need to establish the accounting standard [for financial reporting in hyperinflationary economies]" (Liu, 2007, p.7).

Besides the differences in accounting standards, the IASB showed concern about that implementation guidance, which would be issued by the MOF after the issue of Chinese GAAP in February 2006, might undermine the principles in the accounting standards (Camfferman and Zeff, 2015).

Despite these differences and the concern, the IASB seemed eager to get China's commitment and support for IFRS to be a single set of global financial reporting standards. Thus, Sir David Tweedie attended the ceremony in Beijing on February 15, 2006 for the issue of the new set of Chinese GAAP, at which he acclaimed that "the adoption of the new Chinese accounting standards system brings about substantial convergence between Chinese standards and International Financial Reporting Standards (IFRSs), as set by the International Accounting Standards Board (IASB)" (IASB, 2006).

However, several studies have challenged the "substantial convergence" assertion (e.g. Biondi and Zhang, 2007; Peng and Bewley, 2010; Baker *et al*., 2010). For example, Biondi and Zhang (2007) provided evidence on more differences between Chinese GAAP and IFRS than the ones acknowledged by the MOF and the IASB to doubt the "substantial convergence". Furthermore, Biondi and Zhang (2007) argued that the MOF has developed accounting standards mainly based on the dynamic accounting perspective (leading to matching-based representation and historical cost valuation), while the IASB has established IFRS largely based on the static perspective (leading to fair value valuation).

2.2 Continuing Convergence Stage (2010-2015)

During and after the financial crisis of 2007-2008, the Group of Twenty (G20)[9] addressed accounting as a critical issue for the financial stability. Following the G20 summit between November 14 and 15, 2008, national leaders stated in their communique that "Strengthening Transparency and Accountability", such as promoting the disclosure on financial products and financial conditions, is one of the "Common Principles for the Reform of Financial Markets" (G20, 2008). As one of "Medium-term actions" to strengthen transparency and accountability, national leaders recommended that "regulators, supervisors, and accounting standards setters, as appropriate, should work with each other and the private sector on an ongoing basis to ensure consistent application and enforcement of high-quality accounting standards" (G20, 2008). This means that the heads of states and governments began to pay attentions to the discussion about the issues of global convergence of accounting standards (Camfferman and Zeff, 2015). Afterwards, the G20 further encouraged its members to converge their national GAAPs with IFRS or adopt IFRS. For example, the G20' London Summit held in April 2009 promoted the national accounting standards setters of member countries or regions to "make significant progress towards a single set of high quality global accounting standards" (G20, 2009, p.6).

As a result, all of the G20 member countries or regions, including China, have made public commitments supporting a single set of high quality global accounting standards, namely IFRS. In China, the MOF published a draft version of roadmap concerning convergence with IFRS, titled *Roadmap for Continuing and Full Convergence of Chinese Accounting Standards for Business Enterprises and International Financial Reporting Standards (Exposure Draft)* in September 2009*,* and the final version titled *Roadmap for Continuing Convergence of Chinese Accounting Standards for Business Enterprises and International Financial Reporting Standards* (hereinafter, Roadmap) in April 2010.

In the Roadmap, the MOF asserted that Chinese GAAP had achieved convergence with IFRS, by citing instances including the establishment and implementation of the new set of Chinese GAAP, the equivalence of Chinese GAAP and IFRS adopted by Hong Kong, and the in-process equivalence project of Chinese GAAP and IFRS adopted by the EU (MOF, 2010c).

The MOF further contemplated what needed to be done to consolidate and continue the status quo of the convergence of Chinese GAAP with IFRS. As the IASB planned to finish major revisions of IFRS, such as the accounting standards for consolidated financial statements, fair value measurements and financial statement presentation by 2011 (FASB and IASB, 2008), the MOF declared that it would almost synchronously revise or newly establish corresponding accounting standards in Chinese GAAP (MOF, 2010c). However, the revision process of Chinese GAAP fell behind the schedule set by the Roadmap and the next major revision did not happen until 2014.

Moreover, in the Roadmap, the MOF emphasized that the convergence should be bilateral rather than unilateral, and suggested that if "IFRS aim to achieve high-quality, authority and global recognition, it should fully consider the actual situations in developing countries, especially the countries with emerging market-oriented economies" (MOF, 2010c).

It is worth noting that compared with the draft version, the MOF, in the final version, eliminated the word of "Full" in the title and the statement that "the main problem concerning accounting standards that China should solve is continuing and full convergence" in the text (MOF, 2009b; MOF, 2010c). The MOF did not give any explanation of the reason for the eliminations. Actually, the expression of "full convergence" had not been used by senior officials within the MOF until October 2015, when the MOF and the IFRS Foundation discussed the issue concerning expanding the use of IFRS in China during the Trustees meeting[10] held in Beijing. This can be considered as showing that the MOF was cautious to use the term of "full convergence" in public statements, which might be interpreted as "direct adoption of IFRS".

Under the Roadmap, the MOF initiated the revision of Chinese GAAP since 2012, and in 2014, revised five existing standards and issued three new accounting standards in response to the revision of IFRS. Specifically, the MOF revised ASBE 2 *Long-term Equity Investment* (correspond to the issuance of IFRS 10, IFRS 11, IFRS 12 and the revision of IAS 27, IAS 28 in May 2011) in March 2014, ASBE 9 *Employee Benefits* (correspond to the revision of IAS 19 in June 2011) in January 2014, ASBE 30 *Presentation of Financial Statements* (correspond to revision of IAS 1 in June 2011) in June 2014, ASBE 33 *Consolidated Financial Statements* (correspond to the issuance of IFRS 10 in May 2011) in February 2014, and ASBE 37 *Financial Instruments: Disclosure* (correspond to the publication and revision of IFRS 7 and IAS 32 during 2008 and 2011) in June 2014. The MOF newly established and issued ASBE 39 *Fair Value Measurement* (correspond to the issuance of IFRS 13 in May 2011) in January 2014, ASBE 40 *Joint Arrangements* (correspond to the issuance of IFRS 11 in May 2011) in February 2014, and ASBE 41 *Disclosure of Interests in Other Entities* (correspond to the issuance of IFRS 12 in May 2011) in March 2014. The revised and newly established accounting standards went into effective since the December 2014 fiscal year-end.

The MOF, afterwards, initiated the revision of ASBE 14 *Revenue* (correspond to the issuance of IFRS 15 in May 2014) and issued the exposure draft in December 2015. Latterly, The MOF, initiated the revision of ASBE 16 *Government Assistant*, ASBE 22 *Financial Instruments: Recognition and Measurement* (correspond to the issuance of IFRS 9 in July 2014), ASBE 23 *Transfer of Financial Assets* and ASBE 24 *Hedging* (correspond to the issuance of IFRS 9 in July 2014), and issued the exposure drafts in August 2016. Moreover, the MOF issued the exposure draft of a new accounting standard for *Non-current Assets Held for Sale, Disposal Group and Discontinued Operations* (correspond to the revision of IFRS 5 from 2008 to 2014) in August 2016.

Although the revisions were conducted to eliminate the existing differences between Chinese GAAP and IFRS, and the newly published accounting standards were established mainly by modelling on IFRS, the MOF modified accounting standards in IFRS to accommodate them to Chinese context. For example, the accounting standard for *Non-current Assets Held for Sale, Disposal Group and Discontinued Operations (Exposure Draft)* set a criterion that only when an enterprise gained firm purchase commitment, an asset is allowed to be classified as held for sale (MOF, 2016g). This criterion is not required in IFRS 5. As such, Chinese accounting standard would set more stringent criteria for recognizing assets held for sale than IFRS do.

2.3 Expanding the Use of IFRS in China toward Full Convergence (2015-)

The IFRS Foundation held a Trustees meeting in Beijing between October 13 and 16, 2015, and organized a stakeholder event to promote discussions between stakeholders in China, such as Chinese enterprises, auditing firms and regulators, and the IFRS Foundation. During the same period, representatives of the Trustees of the IFRS Foundation and the MOF held a bilateral meeting, which was led by Michel Prada, Chairman of the IFRS

Foundation Trustees and Dai Bohua, Assistant Minister of the MOF. Discussions in the bilateral meeting covered some options for how to further enhance the cooperation and relationship between the two organizations in the future (IASB, 2015).

Following the bilateral meeting, the IFRS Foundation and the MOF organized a stakeholder event, where Michel Prada gave a keynote speech. During the opening remarks, he briefly concluded the progress of the global convergence of accounting standards since 2000. Next, he stated the Trustees' appreciation of the great progress made by the MOF towards convergence with IFRS, especially, the establishment of the new set of Chinese GAAP in 2006. He argued that the implementation of the new set of Chinese GAAP has "significantly enhanced the quality and consistency of financial reporting within China" (Prada, 2015). Michel Prada presented that China has already deeply involved in the establishment of IFRS since 2006 in various ways such as sending representatives to be a Trustee of the IFRS Foundation, a member of the IASB, a member of the IFRS Interpretations Committee and IFRS Advisory Council members, and providing the secretariat for the IASB's Emerging Economies Group. Finally, Michel Prada went to the point of his speech that "the question I have is, whether 10 years after the Beijing Agreement, is now the time to consider further steps towards the goal of full convergence" (Prada, 2015). He argued that the full convergence would benefit China and stated:

> *My personal view is that China has much to gain in doing so, in terms of international confidence in China's capital market as well as Chinese leadership in establishing standards for global finance. This is particularly true for Chinese companies that are highly internationally exposed and therefore have no difficulty dealing with international standards* (Prada, 2015).

After the Trustees meeting, the IFRS Foundation and the MOF signed and published a Joint Statement (referred to as "2015 Beijing Joint Statement") to update the 2005 Beijing Joint Statements. In the 2015 Beijing Joint Statement, Dai Bohua reaffirmed that the goal of Chinese GAAP establishment is to achieve full convergence with IFRS. The IFRS

Foundation, in turn, assented to ensure Chinese stakeholders' full involvement "in the future development of IFRS" (MOF and IFRS Foundation, 2015). From the MOF's perspective, this means ensuring and even strengthening Chinese influence on the setting of IFRS in order to force IFRS to reflect Chinese-specific accounting environment. Finally, the two organizations announced the plan to establish a joint working group "to explore ways and steps to advance the use of IFRS within China and other related issues, especially for those internationally orientated Chinese companies" (MOF and IFRS Foundation, 2015).

In order to expand the use of IFRS in China, following issues, but not limited to, should be addressed and discussed. One issue is about the "ways", which would be accelerating the process of revising Chinese GAAP to eliminate differences with IFRS or the direct adoption of IFRS in China. If direct adoption, should it be mandatory or voluntary? Another issue is about the "steps", which at least involve the aspect of schedule for making the decision of "ways" and the aspect of the range of Chinese enterprises that are required or permitted to prepare their financial statements in accordance with the new "ways". Moreover, there is an issue regarding how to determine "internationally orientated Chinese companies". For example, "internationally orientated Chinese companies" should be defined as companies that have listed or plan to list shares in overseas capital markets, or the ones that have been conducting business operations in overseas markets.

Moreover, it can be expected that the discussion within the joint working group will be not unilateral, which means that China would uncritically adopt IFRS. On the contrary, the discussion is likely to be bilateral, which means that the IASB would develop IFRS by taking consideration of Chinese-specific accounting environment such as economy and capital markets development. Although China is under increasing exogenous pressures from international organizations such as the IASB and the G20, a consensus within the MOF that accounting standards should reflect the Chinese-specific accounting environment has not changed. The retrospection of the convergence process of Chinese GAAP with IFRS since 2005 showed that this consensus has been shared by successive leaders of the MOF and the Director Generals of the Accounting Regulatory Department within the MOF.

Chapter 3

Relevant Prior Literature Review

Some previous studies had examined various issues concerning the accounting system in China by applying a contextual perspective or related interdisciplinary method, either explicitly or implicitly. As this study investigates the context of the Chinese accounting ecology over the period from 2006 to 2015, prior literature review focuses on the researches that examined the Chinese accounting system during the same period, or provided useful understandings of the contemporary context.

Ezzamel *et al.* (2007) examined the impact of political ideology on accounting regulations in China during two contrasting eras. One era is the period from the 1950s to the late 1970s when the teachings of Mao Zedong (1893-1976), also known as Maoism, were the dominant political ideology. The Maoism emphasized class struggle between the proletariat and the bourgeois, centrally planned economy and public ownership. In such context, Western accounting regulations were viewed as the way to protect the capitalist economic system and the bourgeois' interests. Especially, conservatism was criticized by regulators and accounting academics as a means used by the bourgeois to deliberately understate profits in order to exploit workers, or a way to build secret reserves to evade taxation. Thus, conservatism principle was not adopted in Chinese accounting system and conservatism practices were prohibited under the domination of the Maoism.

Another era is the period since the late 1970s when the ideology developed by Deng Xiaoping (1904-1997), also known as Dengism, was dominant. The Dengism emphasizes the primacy of economy development, the introduction of market-oriented economy, the development of private ownership, and the economic and trade relations with foreign countries. In such context, conservatism practices in Western accounting systems were recognized as a tool that would help Chinese enterprises address market uncertainty and improve the reliability of accounting information. Then, the MOF, in 1992, regulated conservatism as a principle in Chinese accounting regulations.

By using China as a case, Ezzamel *et al.* (2007) documented that the dominant political ideologies in China led by the Maoism or Dengism respectively created contexts that obstruct or approve the adoption of particular Anglo-American accounting concepts, such as the principle of conservatism.

Biondi and Zhang (2007) conducted a comparative analysis of IFRS and the new set of Chinese GAAP from the static and the dynamic perspectives of accounting, and provided explanations for the differences between the two sets of accounting standards by examining the Chinese-specific context. They argued that while the IASB has been largely adopting a static perspective and developing IFRS increasingly based on a market reference (leading to fair value valuation), the MOF appears to take a dynamic perspective and focus on the financial and productive process of the whole enterprise (leading to the historical cost accounting). By utilizing the two distinct perspectives, they conducted a comparative analysis and identified many differences regarding the application of fair value measurement between Chinese GAAP and IFRS. For example, Chinese GAAP allow the use of fair value measurement only when fair values can be reliably measured. For most assets and liabilities, the historical cost remains the benchmark measurement attribute.

Next, Biondi and Zhang (2007) narrowed their focus and cited the accounting standard for business combinations as a paradigmatic example to elucidate the existing differences between IFRS and Chinese GAAP. Specifically, IFRS require all business combinations to apply the purchase method, according to which the net assets acquired in a business combination should be recorded based on the fair values, and acquired goodwill should be recognized. In contrast, Chinese GAAP require business combinations involving entities under common control to apply the pooling of interests method, according to which a business combination should be accounted by using the book values of the merged entities and no goodwill should be recognized. They argued that the purchase method implies the static perspective, viewing a business combination as a purchase and valuating the target entity by using the market-based measurement attribution, namely fair value, while the pooling of interests method implies the dynamic perspective, viewing a business combination as a joining of entities and valuating combined assets and liabilities based on book values. Thus, they concluded that Chinese GAAP appears to be in line with the dynamic perspective rather than the static perspective that mainly characterizes IFRS.

Biondi and Zhang (2007) further provided explanations for the differences by examining the Chinese-specific context. They found that many large corporate groups, especially SOE groups in China have been undergoing reorganizations between/among subsidiaries or subsidiaries and parent companies in order to pursue economies of scale, resources and synergies, and enhance their competitive power. In these business combinations, capital market transactions do not always exist, thus, the purchase method fostered by IFRS 3 may not be appropriate. Furthermore, the purchase method may cause opportunistic accounting treatments regarding fair values and affect the quality of accounting information.

Baker *et al.* (2010) focused on the divergence in the accounting regulation for business combinations between IFRS and Chinese GAAP. Specifically, while the IASB prohibited the pooling of interests method and required the acquisition method for all business combinations, the MOF decided to maintain the pooling of interests method and required it for business combinations involving entities under common control. They further explained this divergence from a political economic perspective and the viewpoint of accounting theory.

Baker *et al.* (2010) argued that from a political economic perspective the MOF's decision to allow the pooling of interests method was driven by the political economic context of China rather than the desire to converge Chinese GAAP towards IFRS. Particularly, the pooling of interests method offers companies greater flexibility to conduct business combinations without resorting to fair values, which are always unreliable. Thus, this method is more desirable in Chinese-specific context, where banks and large industrial groups have been undertaking large-scale internal reorganizations through business combinations within corporate groups.

Moreover, Baker *et al.* (2010) argued that, from the viewpoint of accounting theory, a business combination under common control can be best understood as a merger between/among entities, which is promoted by their common controlling shareholder(s) in order to improve their business activities. A business combination under common control does not involve a change of ownership and thus does not correspond with the acquisition method, which views a business combination as a takeover of a target company by an acquiring company through an acquisition of ownership control in a capital market. Thus, the pooling of interests method might be more preferable than the acquisition method for business combinations under common control.

Baker *et al.* (2010) suggested that the accounting system is embedded in the overall socio-economic system of a specific country, thus, the IASB's focus on the information need of investors and creditors in capital markets, and the move to the fair value model (e.g. only allowing the acquisition method) may not necessarily lead to international accounting convergence.

Peng and Bewley (2010) investigated the adoption of fair value measurement in the new set of Chinese GAAP and the implementation of fair value measurement in Chinese companies. Specifically, they addressed the question as to what extent has the new set of Chinese GAAP adopted fair value measurement. They identified few differences concerning fair value measurement of financial instruments between the new set of Chinese GAAP and IFRS, but many divergences in the application of fair value in initial and subsequent measurements of non-financial long-term asset investments.

Moreover, Peng and Bewley (2010) addressed the questions as to what is the impact of fair value measurement on Chinese listed companies' financial reporting and whether the fair value measurement had been effectively implemented in Chinese listed companies. They found that fair value measurement of financial instruments had resulted in considerable instability in Chinese listed companies' annual financial statements of 2007FY and 2008FY, such as excess volatility in net income and owners' equity. Additionally, they showed that Chinese listed companies were reluctant to use fair value to measure long-term non-financial assets. For example, although Chinese GAAP allow the option between historical cost and fair value for investment properties' subsequent measurements, the majority of Chinese listed companies chose historical cost in their annual financial statements of 2007FY and 2008FY. They further found evidence on Chinese listed companies' non-compliance with the MOF's fair value disclosure requirements. For example, Chinese listed companies did not provide sufficient disclosures regarding the recoverable amounts in asset impairments and how fair values were measured on debt restructuring transactions in their annual financial reports of 2007FY and 2008FY. They suggested that given the complex interactions between the accounting and the economic and political systems, China appears to confront big challenges to develop surrounding institutions to facilitate the successful implementation of fair value measurement.

Qu and Zhang (2015) investigated the value-relevance of earnings and book value reported by Chinese listed companies, and found that the combined value-relevance of earnings and book value had increased significantly over a period of 20 years from 1991 to 2010. The increase in the value-relevance of financial information was consistent with the convergence process of Chinese GAAP with IFRS. They further explored the question as to whether the application of fair value measurement had improved the value-relevance of earnings and book value of Chinese listed companies. They found that when the MOF firstly introduced the fair value measurement and required the application during 1999-2000, the quality of financial information in Chinese listed companies had been worsened rather than improved, as the combined value-relevance of earnings and book value, the incremental value-relevance of earnings, and the incremental value-relevance of book value all decreased during this period. Next, they found that during 2007-2010 when fair value measurement was re-adopted in the new set of Chinese GAAP, the combined value-relevance of earnings and book value had increased in both Chinese listed companies that applied fair value measurement (FV-applied companies) and those that did not apply fair value measurement (non-FV-applied companies).

Particularly, Qu and Zhang (2015) found that for listed companies in the mining and farming industries, the combined value-relevance of earnings and book value in FV-applied companies was very low and insignificant, but high and significant in non-FV-applied companies. They concluded that the evidence in China did not support the assertion that fair value measurement is superior over historical cost measurement and can improve the value-relevance of financial information. Instead, they suggested that in Chinese-specific context, for certain industries such as the farming and mining industries, historical cost may provide financial information with higher value-relevance than fair value does and might be the desirable measurement attribute.

These previous studies provided deep understandings of the accounting system in China, which is a transitional country from a centrally-planned economy to a market-oriented economy and has a different accounting environment from the ones in Anglo-American countries. These previous studies are especially valuable as they investigated the Chinese accounting system that may not fit Western-oriented theoretical perspectives of accounting such as the well-known Continental European model and the Anglo-American model taxonomy.

These previous studies, however, have focused more on the technical aspects of the accounting system, such as present or past accounting standards and practices in China (e.g. Biondi and Zhang (2007) and Baker *et al.* (2010)'s focuses on the accounting standard for business combinations; Peng and Bewley (2010)'s examination on the implementation of fair value measurement in Chinese listed companies) rather than the contextual aspects. Although these studies suggested that current divergences between Chinese GAAP and IFRS rooted in the distinguishing context of China, they provided less detailed analyses on what are the main features of Chinese-specific context, and how Chinese accounting system is affected by or affects the contextual factors such as the economic development, the organizational complexity and the cultural tradition. This gap leads us to concentrate our investigation on the contextual aspects of the accounting system in China.

Moreover, the scope of these previous studies is more “partial” (unidimensional) than “total” (holistic). Specifically, these previous studies investigated partial slices of Chinese accounting environment, such as the influence of political ideology led by Maoism or Dengism on the adoption of conservatism principle (Ezzamel *et al.*, 2007), the impact of organizational structure and industrial development on the accounting for business combinations (Biondi and Zhang, 2007; Baker *et al.*, 2010), the comparison of Chinese

GAAP with IFRS regarding the use of fair value measurement (Peng and Bewley, 2010), and the effect of fair value measurement on the value-relevance of earnings and book value in Chinese listed companies (Qu and Zhang, 2015).

This study, by applying the national accounting ecology framework developed by Gernon and Wallace (1995), aims to provide a holistic view of the accounting scene in China, and offer in-depth analyses of the whole accounting environment in China, including the societal, organizational, professional, individual and accounting slices.

Chapter 4

Research Methods

4.1 Contextual Perspective

The objective of this study is to provide deep understandings of the main features of the accounting environment in China by invoking the accounting ecology framework developed by Gernon and Wallace (1995). Actually, identifying the national accounting environments is an important issue in the process of global convergence of financial reporting. That is because accounting is not only a neutral set of tools addressing ways of recognizing, measuring and reporting, but interactive with its surrounding sociological context including societal, organizational, professional and individual environments (Gernon and Wallace, 1995; Zeff, 2007; Biondi and Zhang, 2007). Particularly, many studies suggested that surrounding sociological contexts played a critical role in the development of accounting standards (e.g. Gray, 1988; Nobes, 1998; Xiao *et al.*, 2004; Perera and Baydoun, 2007; Ezzamel *et al.*, 2007). Furthermore, numerous studies illustrated that differences in surrounding contexts across countries are likely to cause inconsistent interpretations and implementation of IFRS, which may eventually decrease the cross-national comparability of financial reporting (Doupnik and Richter, 2003, 2004; Doupnik and Riccio, 2006; Nobes, 2006; Leuz, 2010; Chand, 2012; Evans *et al.*, 2015). By identifying the context in a specific country and its impacts on accounting, this study may contribute to unravel the underlying causes and sources for the diversification of accounting standards and practices across nations.

This study examines the context in sufficient detail and provides holistic analyses of the environmental factors that are interactive with the Chinese accounting system, such as economic development, organizational structure, education and training of accounting professionals and lobbying activities. This would help us to understand what accounting standards are practical and rational or vice versa in the Chinese-specific context. The examination of contextual aspects of accounting would contribute “practical wisdom”, which goes beyond the technical aspects of accounting and involves judgments and decisions made by actors such as accounting standards setter(s) and accounting professionals, in a specific context (Cooper and Morgan, 2008). Thus, by identifying the Chinese-specific context, this study may provide answers to questions regarding to the "possible, probable and desirable" (Gernon and Wallace, 1995, p.57; Tsunogaya, 2016, p.830) aspects of the global convergence process in China.

With the globalization of accounting standards, the international accounting researches have been focusing more on the universal and regularity in patterns of accounting across the world, and tend to ignore the national uniqueness, particularity and distinctiveness. However, because there are different modes of rationality and values of accounting across countries, and the fact that IFRS have been interpreted inconsistently across countries, the quest for deeper understanding of a single country may reveal the subtle complexities of accounting and may deepen our grasp of the larger pattern such as the global convergence of financial reporting (Gernon and Wallace, 1995). Thus, by identifying the Chinese-specific context, this study may offer valuable insights into the rationality and values of Chinese accounting system, as well as the distinct motivation, policy and background of the global convergence of financial reporting in China.

4.2 Case Study Approach

This study adopts the case study approach to analyze the Chinese-specific context. Cooper and Morgan (2008) suggested that the case study approach is useful when the research aims to examine:

(1) the complex and dynamic phenomena, which involve multitudinous variables, including those that are not quantifiable;
(2) the details of infrequent but significant activities, such as changes in accounting regulations;
(3) the phenomena in which the context is crucial because of its interactions with the phenomena (Cooper and Morgan, 2008, p.160).

This study focuses on the convergence with IFRS in China, aiming to examine the Chinese-specific context that interacts with the convergence process. This context includes both quantifiable factors such as the economy growth rate and the number of accounting professionals, and unquantifiable factors such as the education of accounting professionals and accounting policy choices made by individuals. Thus, we consider the case study approach is appropriate to investigate the Chinese-specific context.

Furthermore, the case study approach has several advantages. First, the case study is sensitive to context, and encourages researchers to consider questions and issues that may have been ignored by other research approaches such as the positive theory and the classification of national accounting systems. Second, the case study approach is suited to answer "how" and "why" questions (Cooper and Morgan, 2008, p.160). Specifically, the case study approach is valuable in describing the details of how accounting innovations, such as fair value measurement, have been adopted and applied in a certain country, and illustrating why the convergence with or adoption of IFRS happened or did not happen in a certain country.

4.3 Theoretical Framework

Gernon and Wallace (1995) developed a so-called national accounting ecology framework to provide an integrated and holistic view of country-specific accounting scenes. This framework considers that accounting is a complex system influenced by various contextual factors such as national culture, economic development and accounting professionals' education. In this framework, no one factor occupies a predominant position because overemphasizing one or several factors and their influence cannot provide a broad understanding of accounting practices (Gernon and Wallace, 1995). Moreover, the accounting ecology framework emphasizes the interrelationships among the contextual factors. According to Gernon and Wallace (1995), the accounting ecology in a country includes five individual but interactive components as shown in Figure 4.1:

(1) Societal environment: including cultural variables such as language, ethnic origin, religion, belief systems, and shared values; structural variables such as economic,

technological and legal development; and demographic variables such as a country's population and geographical location. These variables may affect the demand for financial accounting services.

(2) Organizational environment: including such variables as organizational size, technology, complexity, organizational culture and human and capital resources. These variables may influence the rationalizations in the option and design of accounting systems and the demand for accounting services in a country.

(3) Professional environment: including variables related to the accounting profession such as the education, training, registration, discipline, professional ethics and culture of accountants and auditors.

(4) Individual environment: referring to accounting policy choices made by individuals such as professional bodies and accounting standards setters, and comprising the whole setting in which individuals lobby standard setters and use accounting numbers to pursue respective interests.

(5) Accounting environment: encompassing variables relevant to financial reporting rules and practices, such as the disclosure and measurement requirements and practices, the types and frequency of accounting reports. These variables are influenced by and proactively affect variables in the other environments.

The national accounting ecology framework enables a comprehensive description of the milieu in which accounting operates (Gernon and Wallace, 1995). Perera and Baydoun (2007), Hellmann *et al*. (2010), Poudel *et al*. (2014), and Tsunogaya *et al*. (2015) demonstrated the framework's applicability to examine country-specific accounting environments through studies into Indonesia, Germany, Nepal and Japan, respectively. Perera and Baydoun (2007) clarified that contextual factors in Indonesia such as the "credit-insider" financing system, the legal system featuring paternalistic protection, and the Islam tradition and its strong influence on business activities, would make IFRS implementation in Indonesia a challenging task. Hellmann *et al*. (2010) illustrated that contextual factors in Germany such as the conservative cultural tradition, uniformity and statutory control, the "credit-insider" system, and the close relationship between taxation and accounting, may hinder consistent interpretations and applications of IFRS in Germany. Poudel *et al*. (2014) illustrated that contextual factors in Nepal such as widespread corruption, underdeveloped capital market, and a lack of qualified and well-trained accountants are likely to hinder consistent interpretations and applications of IFRS in Nepal. Thus, the direct adoption of IFRS in Nepal does not necessarily improve the comparability and transparency of financial reporting prepared by Nepalese companies. Tsunogaya *et al*. (2015) demonstrated that Japan's distinct contextual factors such as the high weight of the manufacturing industry, long-term oriented business practices, the coordinated market economy, and the relatively small size of accounting professionals, are likely to impede the mandatory adoption of IFRS in Japan.

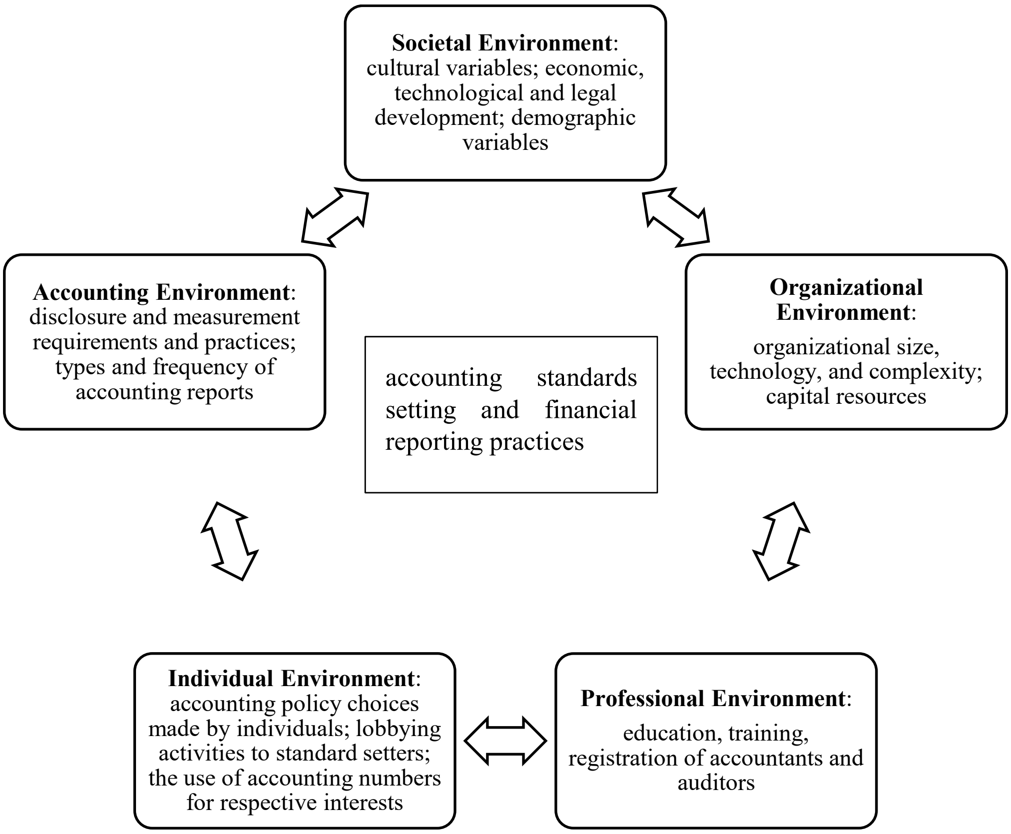

Figure 4.1: Accounting Ecology Framework

Source: prepared by the author based on Gernon and Wallace (1995).

4.4 Data Collection

Yin (2003) noted that the case study must show sufficient evidence and consider alternative perspectives, thus, the researcher should conduct exhaustive examination of the relevant evidence. We collected data used in this study from multiple sources including primary sources and secondary documents. The primary sources include works and speeches by prominent Chinese politicians such as Deng Xiaoping and Zhu Rongji, and the pronouncements of the Communist Party of China (CPC) and the State Council. That is because these politicians and organizations had/have hegemonic influence on Chinese political policy decisions, which affect the Chinese accounting environment, either directly or indirectly.

Moreover, we searched exhaustively official publications, speeches and pronouncements of senior officials within the MOF. That is because the MOF is the only authority to be responsible for the establishment of Chinese accounting standards. The statements of senior officials within the MOF help us to explore Chinese accounting standards setter's rationality and values regarding accounting, and opinions on IFRS adoption and global convergence of financial reporting. In addition, we examined accounting standards, guidelines (*yingyongzhinan*), interpretations (*jieshi*), and explications (*jiangjie*) issued by the MOF in order to discern the development and features of Chinese accounting regulations. We also reviewed documents related with the development of Chinese accounting professionals issued by the MOF, such as training projects. That is because the MOF is the major actor to design, establish and improve the development of Chinese accounting professionals (Wang, 2012).

Besides these archival data sources, we use extensive statistical data to provide empirical evidence on the features of Chinese-specific context. The statistical data are reliable because they were collected from statistics published by authoritative parties such as the National Bureau of Statistics of China, the CSRC, Shanghai Stock Exchange and Shenzhen Stock Exchange.

Regarding the secondary documents, we scrutinized the MOF's analytical reports on the implementation of the new set of Chinese GAAP in order to detect the practical problems and the influence of new accounting standards on financial statements of Chinese listed companies. We also examined the CSRC's regulatory reports in order to understand the problems related to the interpretation and application of the new set of Chinese GAAP, and the auditing of financial statements prepared by Chinese listed companies in accordance with the new set of Chinese GAAP.

Additionally, the secondary documents include articles and books containing investigations and analyses of Chinese accounting system and surrounding institutions by Chinese and foreign academics, accounting professionals in China, and officials in Chinese regulatory organizations, as well as investigation reports by international organizations such as the World Band, and foreign organizations such as the Financial Services Agency in Japan.

Chapter 5

Analyses of the Chinese Accounting Ecology

5.1 Societal Environment

The societal environment refers to demographic, cultural, and structural variables such as the level of technological, economic, and political development. After establishing the People's Republic of China as a socialist state in 1949, Mao Zedong (1893-1976), the former leader of China, adopted a Soviet-style centrally-planned economic system characterized mainly by central planning and state ownership (Wu, 2005). Due to economic blockades by Western countries beginning in the 1950s and the diplomatic rupture with the former Soviet Union from the early 1960s, Mao emphasized a "self-reliance" (*ziligengsheng*) policy and encouraged the development of an independent domestic economic system. This inward-oriented economic policy lasted until the 1970s and led to stagnancy and depression in China's foreign trade (Wu, 2005). After the death of Mao, Deng Xiaoping (1904-1997) became the leader of China. Deng initiated the "Reform and Opening Up" (*gaigekaifang*) [11] policy in 1978 to accelerate Chinese economic development by promoting the inflow of FDI and introducing market principles and mechanisms. Compared to Mao's economic policy that emphasized independence and self-reliance, Deng proposed an export-oriented industrialization policy aiming to expand exports of manufactured goods (Wu, 2005).

With the implementation of the "Reform and Opening Up" policy since the late 1970s, FDI and foreign trade largely contributed to the growth of Chinese economy. China has been one of the fastest growing economies for more than 30 years. Table 5.1 shows the annual growth rates of China's real Gross Domestic Product (GDP) from 1978 to 2014. Based on these data, we can get an average growth rate of approximately 9.8 % per annum during this period. In terms of nominal GDP, China became the second largest economy after the United States in 2010. Table 5.2 summarizes the annual amount of the inflow of FDI in China and shows that the "Reform and Opening Up" policy resulted in a significant increase of FDI in China since the 1980s. Table 5.3 indicates that the value of imports and exports of goods had rapidly increased since 1978. Figure 5.1 shows that the increase in foreign trade was one important component supporting Chinese GDP growth. For example, the value of exports and imports accounted for 41.5% of Chinese nominal GDP in FY 2014 (National Bureau of Statistics of China, 2015). The EU, the United States, and Japan were the most important bilateral trading partners with China. They were also major contributors of FDI in China. Along with the integration of Chinese economy into the global economic system, Chinese enterprises have gradually globalized their business and organizational activities. This, in turn, placed China under the pressure to converge its domestic accounting standards with IFRS (Kanbur and Zhang, 2005; Biondi and Zhang, 2007; Doupnik and Perera, 2012). Actually, the MOF mobilized exogenous pressures from the economic globalization to promote the convergence of Chinese GAAP with IFRS. Wang Jun, former Vice Minister of the MOF, recognized:

> *European and Asian countries are China's major trading partners and sources of foreign investment. With the increased trade and capital flows between China and these countries, accounting information is playing a more important role in promoting bilateral economic and trade cooperation. Parties engaged in international trade and international capital providers both need high-quality, comparable and understandable accounting information as basis for decision-making"* (Wang, 2006a).

Further, Wang Jun emphasized that converging Chinese GAAP with IFRS would benefit "the further integration of the Chinese economy into the global economic system and foreigners' understanding of China" (Wang, J., 2005, p.3).

Despite of the rapid growth of Chinese economy, Table 5.4 shows that the secondary sector, such as mining and manufacturing industries, contributed largely to Chinese GDP. For example, 42.7% of Chinese GDP in FY 2014 came from the secondary sector (National Bureau of Statistics of China, 2015). For the secondary sector, "the value is generated in business by purchasing inputs, transforming them according to a business plan, and selling the consequent products over cost" (Nissim and Penman, 2008, p.14). Thus, the relatively high weight of the secondary sector may impede the extensive application of fair value measurement in China.

Table 5.1: China's Real GDP Growth Rate

	GDP growth (annual %)
1978	11.9
1979	7.6
1980	7.8
1981	5.2
1982	9.0
1983	10.8
1984	15.2
1985	13.6
1986	8.9
1987	11.7
1988	11.3
1989	4.2
1990	3.9
1991	9.3
1992	14.3
1993	13.9
1994	13.1
1995	11.0
1996	9.9
1997	9.2
1998	7.9
1999	7.6
2000	8.4
2001	8.3
2002	9.1
2003	10.0
2004	10.1
2005	11.4
2006	12.7
2007	14.2
2008	9.6
2009	9.2
2010	10.6
2011	9.5
2012	7.8
2013	7.7
2014	7.3

Source: the World Bank (available at http://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG).

Table 5.2: The Total Value of FDI in China

Unit: 100 million USD

	The total value of FDI inflow for the year
1979-1982	17.69
1983	9.16
1984	14.19
1985	19.56
1986	22.44
1987	23.14
1988	31.94
1989	33.92
1990	34.87
1991	43.66
1992	110.08
1993	275.15
1994	337.67
1995	375.21
1996	417.26
1997	452.57
1998	454.63
1999	403.19
2000	407.15
2001	468.78
2002	527.43
2003	535.05
2004	606.30
2005	603.25
2006	630.21
2007	747.68
2008	923.95
2009	900.33
2010	1,057.35
2011	1,160.11
2012	1,117.16
2013	1,175.86
2014	1,195.62

Source: *China Compendium of Statistics 1949-2008,* p.62 and *China Statistical Yearbook 2015* (available at http://www.stats.gov.cn/tjsj/ndsj/2015/indexeh.htm).

Table 5.3: The Value of Foreign Trade in China

Unit: 100 million RMB

	The value of imports and exports of goods	The value of exports of goods	The value of imports of goods
1978	355.0	167.6	187.4
1979	454.6	211.7	242.9
1980	570.0	271.2	298.8
1981	735.3	367.6	367.7
1982	771.3	413.8	357.5
1983	860.1	438.3	421.8
1984	1,201.0	580.5	620.5
1985	2,066.7	808.9	1,257.8
1986	2,580.4	1,082.1	1,498.3
1987	3,084.2	1,470.0	1,614.2
1988	3,821.8	1,766.7	2,055.1
1989	4,155.9	1,956.0	2,199.9
1990	5,560.1	2,985.8	2,574.3
1991	7,225.8	3,827.1	3,398.7
1992	9,119.6	4,676.3	4,443.3
1993	11,271.0	5,284.8	5,986.2
1994	20,381.9	10,421.8	9,960.1
1995	23,499.9	12,451.8	11,048.1
1996	24,133.8	12,576.4	11,557.4
1997	26,967.2	15,160.7	11,806.5
1998	26,849.7	15,223.6	11,626.1
1999	29,896.2	16,159.8	13,736.4
2000	39,273.2	20,634.4	18,638.8
2001	42,183.6	22,024.4	20,159.2
2002	51,378.2	26,947.9	24,430.3
2003	70,483.5	36,287.9	34,195.6
2004	95,539.1	49,103.3	46,435.8
2005	116,921.8	62,648.1	54,273.7
2006	140,974.0	77,597.2	63,376.9
2007	166,863.7	93,563.6	73,300.1
2008	179,921.5	100,394.9	79,526.5
2009	150,648.1	82,029.7	68,618.4
2010	201,722.1	107,022.8	94,699.3
2011	236,402.0	123,240.6	113,161.4
2012	244,160.2	129,359.3	114,801.0
2013	258,168.9	137,131.4	121,037.5
2014	264,241.8	143,883.7	120,358.0

Source: *China Compendium of Statistics 1949-2008, p.60* and *China Statistical Yearbook 2015* (available at http://www.stats.gov.cn/tjsj/ndsj/2015/indexeh.htm).

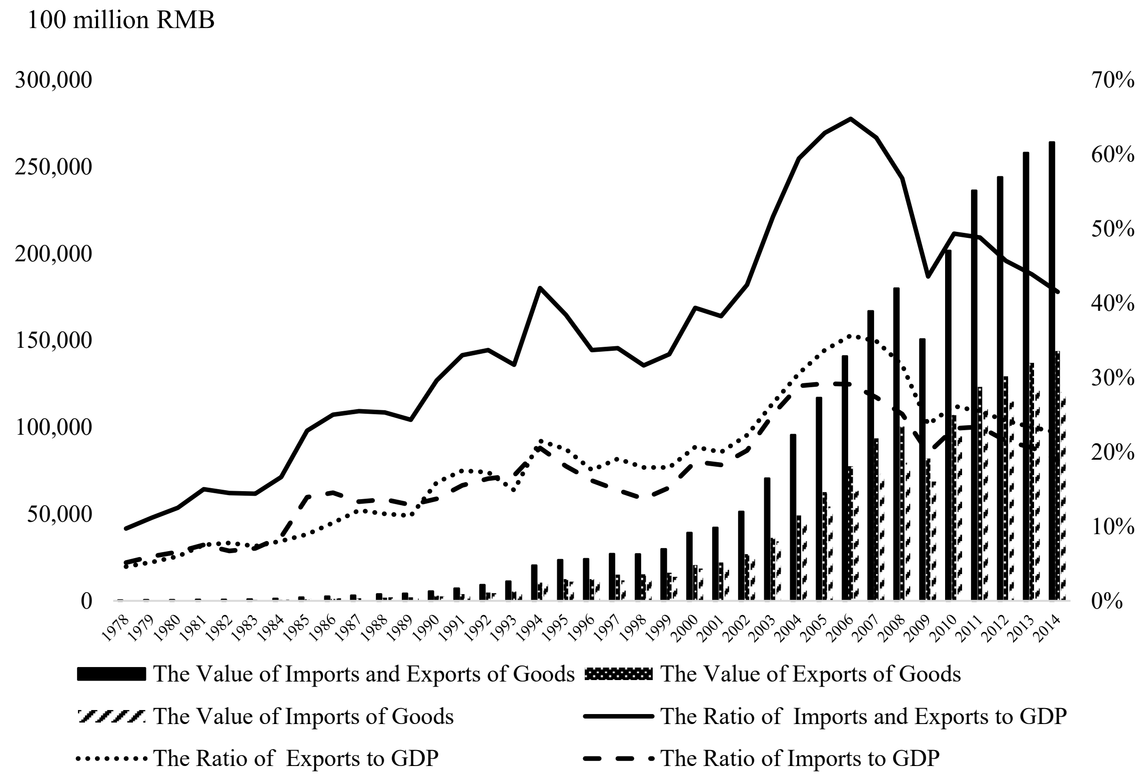

Figure 5.1: Foreign Trade Growth and Its Significance for the Chinese Economy
Source: prepared by the author using data from *China Compendium of Statistics 1949-2008,* p.60 and *China Statistical Yearbook 2015* (available at http://www.stats.gov.cn/tjsj/ndsj/2015/indexeh.htm).

Actually, Jia Wenqin, the Chief Accountant and the head of the Accounting Department within the CSRC, stated:

> *Chinese economy is still largely based on the real economy,*[12] *such as the manufacturing industry. There are not as numerous financial innovations in China as in capital markets of Western countries. Accounting information users, including investors, are still making judgments of corporate performance and firms' future development on the basis of realized profits by comparing revenues and matched expenses. This decides that the scope and levels of fair value measurement should be different from countries with developed market economies* (Jia, 2010, p.7).

Another important aspect of the societal environment is the national culture, which contributes to the "values and orientations of persons and groups" (Gernon and Wallace, 1995, p.62), such as accounting professionals and accounting standards setters, towards accounting. The Chinese culture is characterized mainly by the teachings of Confucius (also known as Confucianism), which have played an important role in forming Chinese economy and accounting systems (Hofstede and Bond, 1988; Yee, 2009, 2012; Yang, 2012). Confucianism was formally adopted as the official moral and political ideology in China about 2,200 years ago, during the Han Dynasty (202BC-220AD), and afterwards, became a perpetuated traditional belief of Chinese people (Yao, 2000; Yee, 2009). Although the teachings of Confucius were fiercely criticized during 1970s (Zhang and Schwarts, 1995), numerous studies demonstrated the continuing prevalence of Confucianism in contemporary Chinese society and the influence of Confucianism on the forming of economic, social, and political institutions in China (e.g. Braendle *et al*., 2005; Yee, 2009; Yang, 2012).

The main objective of Confucianism is to achieve harmony in a complex society by establishing a strong and orderly hierarchy among people (Yang, 2012). In a highly hierarchical society, the superior should be benevolent to and take care of the subordinate, and the subordinate owes the superior obedience and loyalty (Ross, 2003; Yee, 2009). People in this cultural environment are more likely to accept unequal rights and respect authority. As such, accountants in China are likely to prefer to implement relatively prescriptive and detailed requirements rather than the flexibility of accounting standards and the excessive application of accountants' professional judgments (World Bank, 2009; ICAS, 2010).

Moreover, Confucianism values "thrift" and requires not spending more money than necessary, leading to saving and accumulating capital for reinvestment to achieve permanent development of enterprises (Hofstede and Bond, 1988; Uy, 2009; Ji and Dimitratos, 2013). The emphasis on capital accumulation is likely to prevent excessive distributions and lead to prudent and conservative virtues. Moreover, the long-term perspective provides a rationale for that Chinese policy makers emphasize enterprises' permanent or sustainable incomes, which are incomes from market transactions of goods and services rather than from fluctuations in market prices of assets and liabilities.

Table 5.4: The Composition of Chinese GDP

	Primary sector (%)	Secondary sector (%)	Tertiary sector (%)
1978	27.9	47.6	24.5
1979	30.9	46.8	22.3
1980	29.9	47.9	22.2
1981	31.6	45.8	22.6
1982	33.0	44.5	22.5
1983	32.8	44.1	23.1
1984	31.8	42.8	25.5
1985	28.1	42.6	29.3
1986	26.8	43.4	29.8
1987	26.5	43.2	30.3
1988	25.4	43.4	31.2
1989	24.7	42.4	32.9
1990	26.7	40.9	32.4
1991	24.2	41.4	34.5
1992	21.4	43.0	35.6
1993	19.4	46.1	34.5
1994	19.5	46.1	34.4
1995	19.7	46.7	33.7
1996	19.4	47.0	33.6
1997	18.0	47.0	35.0
1998	17.2	45.7	37.1
1999	16.1	45.3	38.6
2000	14.7	45.4	39.8
2001	14.1	44.7	41.3
2002	13.4	44.3	42.3
2003	12.4	45.5	42.1
2004	13.0	45.8	41.2
2005	11.7	46.9	41.4
2006	10.7	47.4	41.9
2007	10.4	46.7	42.9
2008	10.3	46.8	42.9
2009	9.9	45.7	44.4
2010	9.6	46.2	44.2
2011	9.5	46.1	44.3
2012	9.5	45.0	45.5
2013	9.4	43.7	46.9
2014	9.2	42.7	48.1

Source: China Statistical Yearbook 2015 (available at http://www.stats.gov.cn/tjsj/ndsj/2015/indexch.htm).

Actually, the MOF emphasized:

> *Listed companies in the manufacturing industry ought to manage their main businesses well. Only by this, they can achieve long-term development and*

contribute to social wealth growth. Otherwise, [the increase in profits] should be considered as the redistribution of wealth (MOF, 2008).

5.2 Organizational Environment

The organizational environment encompasses variables such as firm size, complexity, capital resources, and corporate governance, which relate to appropriateness in the choice and design of accounting systems and the demand for accounting services. Chinese capital markets have a relatively short development history. In the centrally-planned economy, the Chinese central government controlled almost all economic resources such as funds and materials, and distributed these resources to every individual SOE according to the estimated needs for fulfilling national economic plans (Wu, 2005). The capital market was considered incompatible with a centrally-planned economy and was closed in the 1950s (Zhang, 2001). With the introduction of market mechanisms since 1978, the capital market was re-introduced in China as one important institution of a market-oriented economy. Two major domestic capital markets, the Shenzhen Stock Exchange and the Shanghai Stock Exchange, were established in December 1990. Thereafter, issuing shares to the public and listing stocks on exchanges became one important fund-raising method for Chinese companies.

Table 5.5 shows a rapid growth in the number of Chinese listed companies and the amount of funds raised in capital markets since the early of 1990s. With the development of Chinese capital markets, outside investors need high-quality financial information for their investment decision-making. As such, the development of Chinese capital markets has been one of the most important forces to drive the convergence of Chinese GAAP with IFRS (Zhang and Lu, 2007).

Additionally, an increasing number of Chinese enterprises issued shares and listed their stocks in overseas capital markets such as the Stock Exchange of Hong Kong,[13] the New York Stock Exchange, NASDAQ, the London Stock Exchange, the Singapore Exchange, and the Australian Securities Exchange. Among these overseas capital markets, the Stock Exchange of Hong Kong has been the most important one.[14] Table 5.5 shows a growth in

Table 5.5: The Development of Chinese Listed Companies

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Number of listed companies in Chinese domestic capital markets	10	14	53	183	291	323	530	745	852	949	1,088	1,160	1,224
Number of Chinese companies listed on the Stock Exchange of Hong Kong	0	0	0	6	15	18	25	42	43	46	52	60	75
Amount of funds raised in Chinese domestic capital markets by public offering of shares (100 million RMB)	-	-	69	245	214	100	308	860	787	874	1,516	1,238	720
Amount of funds raised on the Stock Exchange of Hong Kong by public offering of shares (100 million RMB)	0	0	0	61	189	32	101	388	38	47	562	73	192

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Number of listed companies in Chinese domestic capital markets	1,287	1,377	1,381	1,434	1,550	1,625	1,718	2,063	2,342	2,494	2,489	2,613
Number of Chinese companies listed on the Stock Exchange of Hong Kong	93	111	122	143	148	153	159	165	171	179	185	205
Amount of funds raised in Chinese domestic capital markets by public offering of shares (100 million RMB)	666	651	339	2,374	7,815	3,312	4,834	9,800	7,154	4,542	4,284	7,468
Amount of funds raised on the Stock Exchange of Hong Kong by public offering of shares (100 million RMB)	537	648	1,666	3,073	927	311	1,068	2,343	732	998	1,064	2,253

Source: prepared by the author using data from *China Statistical Yearbook 2014* (available at http://www.stats.gov.cn/tjsj/ndsj/2014/indexce.htm), *China Statistical Yearbook 2015* (available at http://www.stats.gov.cn/tjsj/ndsj/2015/indexch.htm), *China Securities and Futures Statistical Yearbook 2012*, p.10, and *China Securities and Futures Statistical Yearbook 2015*, p.16.

Note: the data about the amount of funds raised in Chinese domestic capital markets by public offering of shares in 1990 and 1991 are not available.

the number of Chinese companies listed on the Stock Exchange of Hong Kong and the amount of funds raised there. Major overseas capital markets require or permit foreign companies whose securities are publicly traded there to report consolidated financial statements in accordance with IFRS. Thus, overseas listed Chinese companies need to conduct reconciliation of financial statements prepared under Chinese GAAP to IFRS, leading to an increase in the cost of financing in overseas capital markets.

The MOF acknowledged that eliminating differences between Chinese GAAP and IFRS would reduce reconciliations of financial statements and benefit Chinese enterprises that had raised or intend to raise funds in the global capital market. This was one of the MOF's motivations to promote the convergence of Chinese GAAP with IFRS. For example, Wang Jun, former Vice Minister of the MOF, stated that "if [Chinese companies] get listed in different capital markets simultaneously, [they] need to provide financial statements in accordance with different accounting standards. Great differences in accounting standards among countries or regions will largely increase the financial statements conversion costs for enterprises, consequently increase the cost of listing" (Wang, 2006c). Wang Jun further stated that in the trend of global convergence of accounting standards, "establishing Chinese GAAP by using IFRS for reference" will encourage Chinese enterprises to "go out [to overseas capital markets] with low cost" (Wang, 2006c). Wang Jun's statement provides evidence that the MOF recognized that the convergence of accounting standards would reduce overseas-listing Chinese companies' cost of capital.

Although an increasing number of Chinese companies have been raising funds in overseas capital markets, the Chinese government does not allow foreign companies to issue shares or get listed on Chinese domestic stock exchanges. Moreover, the Chinese government has been limiting the investment of foreign investors in Chinese domestic capital markets. Specifically, the CSRC has applied a so-called Qualified Foreign Institutional Investor (QFII) system. This system permits only overseas institutional investors that acquired the CSRC's approval to invest in shares and company bonds listed in Chinese domestic capital markets. Furthermore, the State Administration of Foreign Exchange (SAFE) controls QFIIs' investment amounts and awards investment quota to each QFII. Until October 27, 2016, 273 QFIIs were approved with total investment quotas worth 84.4 billion USD (SAFE, 2016). This accounted for only about 1% of the total market capitalization of Chinese domestic stock markets, which was about 7,274.3 billion USD on September 30, 2016 (CSRC, 2016).

Chinese regulators' restrictions on foreign investments has led to marginal importance of foreign investors in Chinese domestic capital markets. For most Chinese listed companies, major users of their financial reporting are domestic investors. This provides a rationale for the MOF and the CSRC to consider that the direct adoption approach (either mandatory or voluntary) is not necessarily suitable for Chinese context, as IFRS largely focus on meeting the financial information needs of investors in the global capital market, and are likely to ignore the needs of Chinese domestic investors (Li, X., 2011). Specifically, the CSRC considered that Chinese domestic investors may not necessarily have strong demand for financial information based on fair value. For example, Jia Wenqin, the Chief Accountant and the head of the Accounting Department within the CSRC, stated:

> *[The MOF] should consider the features of investors in China and consider the adoption of fair value on the premise to meet the information needs of users in Chinese capital markets. ... Investors in Chinese domestic capital markets have not made a strong appeal for fair value-related information. In the process of establishing accounting standards, [the MOF] should take investors' above-mentioned feature into consideration when decides the policy regarding fair value* (Jia, 2010, p.9).

Furthermore, among over 60,000 Chinese GAAP-applying enterprises, only 2,995 (as of November 20, 2016) are publicly traded companies. These data show that most Chinese GAAP-applying enterprises are not capital market-oriented business entities.[15] Thus, Chinese enterprises are likely to have weak incentives to provide relevant financial information and extensive disclosure to outside investors and creditors.

Moreover, most Chinese GAAP-applying enterprises are unlisted and medium-sized. For these enterprises, a switch to IFRS is not likely to bring benefits such as a decrease in the cost of capital and easier access to the global capital market. On the contrary, the switch would impose high implementation costs such as updating accounting systems and recruiting or re-training financial staffs.

Table 5.6: Funds Raised in Chinese Domestic Capital Markets versus Bank Loans

Year	Capital raised in Chinese domestic capital markets (direct financing) (100 million RMB)	Bank loans (indirect financing) (100 million RMB)	Ratio of direct financing to indirect financing (%)
1993	314.54	6,335.40	5.0
1994	138.05	7,216.62	1.9
1995	118.86	9,339.82	1.3
1996	341.52	10,683.33	3.2
1997	933.82	10,712.47	8.7
1998	803.57	11,490.94	7.0
1999	897.39	10,846.36	8.3
2000	1,541.02	13,346.61	11.6
2001	1,182.13	12,439.41	9.5
2002	779.75	18,979.20	4.1
2003	823.10	27,702.30	3.0
2004	862.67	19,201.60	4.5
2005	338.13	16,492.60	2.1
2006	2,463.70	30,594.90	8.1
2007	7,722.99	36,405.60	21.2
2008	3,534.95	41,703.70	8.5
2009	5,719.91	95,940.00	5.3
2010	10,190.93	79,510.73	12.8
2011	9,649.29	74,700.00	12.9

Source: *China Securities and Futures Statistical Yearbook 2012*, p.17.
Note: Capital raised in Chinese domestic capital markets includes funds raised through issuing shares and company bonds.

Regardless of firm size, commercial banks are the most important funds providers for Chinese enterprises. Table 5.6 shows that the amount of funds from shares and company bonds issuance (so-called direct financing) were fairly smaller than the amount of bank loans (so-called indirect financing). For example, although the amount of funds raised through direct financing in Chinese domestic capital markets reached a peak of 10,190.93

million RMB in 2010, this amount only accounted for 12.8% of bank loans in the same year. Even in 2007, the ratio of direct financing to indirect financing reached the highest level of 21.2%, it was still relatively low.

The four largest commercial banks that are controlled by the Chinese government, [16] provide a large portion of loans to Chinese enterprises. For example, in 2015, the four largest state-owned commercial banks provided nearly 40% of all loans that year.[17] Furthermore, they provided most of the loans to SOEs (Lu and Yao, 2004), because they are always under strong political pressure to provide loans to government-supported SOEs, even when the SOEs are in financial distress (Martin, 2012). Thus, most loan decisions made by the four state-owned commercial banks are significantly influenced by political pressure and not necessarily based on the debtors' financial status. This is likely to reduce the demand of Chinese commercial banks for transparent financial information to make their lending decisions.

5.3 Professional Environment

The professional environment refers to the education, training, registration and discipline of accountants and auditors, professional ethics and traditions, as well as the quality of auditing. China has a comparatively short development history of its accounting profession. The Chinese public accountants re-emerged in 1980, [18] while Certified Public Accountants (CPAs) in the United States emerged in 1896 (Zeff, 2003; Chen, 2008; Yee, 2009). The MOF and Chinese leaders, from 1980s onward, emphasized the development of China's accounting professionals. Particularly, Zhu Rongji, former Vice Premier (1991-1997) and former Premier (1997-2003), recognized that the development of China's accounting professionals is important for the establishment of a market-oriented economy (Zhu, 1996). Zhu Rongji's interest in establishing a Western-style accounting profession and his hegemonic influence on Chinese political policy decisions provided reformers within the MOF with a favorable political opportunity to improve the education and training of Chinese accounting professionals by introducing courses consistent with international accounting and auditing standards. Furthermore, the MOF received financial aid from the

World Bank and technical support from Deloitte Touche Tohmatsu, an international accounting firm, to overcome the deficiency in funds and expertise. With the political, financial and technical supports, the MOF enhanced the training of Chinese accounting professionals to improve their competence in applying international accounting and auditing standards (Suzuki *et al*., 2007).

Especially, with political support from Chinese leaders and financial aid from the World Bank, in the early 2000s, the MOF established three NAIs in Beijing, Shanghai and Xiamen. The NAIs are government-funded institutes to provide accounting-centered trainings to Chinese accounting professionals. Trainings in the three NAIs are mandatory for a cadre of CPAs, Chief Executive Officers (CEOs) of SOEs, Chief Financial Officers (CFOs) of large enterprises, and senior officials within regulators such as the MOF and the CSRC (Suzuki *et al*., 2007). Training courses at the three NAIs include accounting practices, auditing techniques, and professional ethics, which are consistent with international accounting and auditing standards (World Bank, 2010). Through these training courses, a small cadre of elites in the Chinese accounting profession has been equipped with sound knowledge and skills to apply IFRS. Importantly, these well-trained accounting professionals provided the MOF with the necessary professional infrastructure to introduce fair value measurement and principles-based accounting standards into Chinese GAAP (Graham *et al*., 2013).

Although there was a dramatic improvement in China's accounting professionals, the infrastructure is still considered as incompetent to support consistent interpretations and applications of IFRS in China. First, the number of China's CPAs is relatively small. Specifically, the number of CPAs per one million in China is approximately 161 (217,742/1,350 mil.), while in the United States, it is 1,087 (342,490/315 mil.), [19] meaning that China only has one-seventh the number of CPAs per one million as the United States. Importantly, according to the regulations of the MOF and the CSRC,[20] less than 0.5% of accounting firms (40 (as shown in Table 5.7) of 8,350), and consequently, only about 11% of CPAs (about 24,146 (as shown in Table 5.7) of 213,376)[21] in China are eligible to audit listed companies. This shows a relative lack of qualified CPAs in China. The size of the

Table 5.7 Accounting Firms That Acquired Licenses to Audit Listed Companies

Accounting firms	The number of CPAs in each accounting firm
Ruihua Certified Public Accountants	2,357
BDO China Shu Lun Pan Certified Public Accountants	1,920
Pan-China Certified Public Accountants	1,399
ShinWing Certified Public Accountants	1,186
WUYIGE Certified Public Accountants	1,139
Da Hua Certified Public Accountants	1,063
PwC China	1,007
Ernst & Young China	910
Deloitte China	849
Baker Tilly China	835
GrantThornton	831
CHW CPA Limited Liability Partnership	655
KPMG China	646
Zhongxingcai Guanghua Certified Public Accountants	609
China Audit Asia Pacific Certified Public Accountants	572
Xinghua Certified Public Accountants	520
Reanda Certified Public Accountants	514
Uniion Power Certified Public Accountants	456
Zhongxinghua Certified Public Accountants	454
Jonten Certified Public Accountants	451
Zhonghui Certified Public Accountants	412
Zhongqin Wanxin Certified Public Accountants	391
Zhongzhun Certified Public Accountants	366
Yong Tuo Certified Public Accountants	362
Huapu Tianjian Certified Public Accountants	344
Talent Certified Public Accountants	333
Asia Pacific (Group) Certified Public Accountants	323
Tianyuanquan Certified Public Accountants	288
Zhongxi Certified Public Accountants	275
Beijing Zhongzhengtiantong Certified Public Accountants	273
Jiangsu Gongzheng Tianye Certified Public Accountants	264
Xigema Certified Public Accountants	258
GP Certified Public Accountants	253
Zhonghua Certified Public Accountants	252
Jiangsu Suya Jincheng Certified Public Accountants	249
Shanghai Certified Public Accountants	244
Lixin Zhonglian Certified Public Accountants	240
Sichuan Huaxin (Group) Certified Public Accountants	230
Fujian Huaxing Certified Public Accountants	213
Shan Dong He Xin Certified Public Accountants	203
	Total 24,146

Source: prepared by the author using data from the MOF and the CSRC (available at http://www.csrc.gov.cn/pub/zjhpublic/G00306213/201403/W020140310620717659195.pdf), and the Chinese Institute of Certified Public Accountants (CICPA) (available at http://www.cicpa.org.cn/news/201508/W020150803590945780015.pdf).

accounting professionals in a country is often used as a proxy for auditing quality (Saudagaran, 2009). The small size of China's CPAs may impair auditing quality in China. Consequently, it may challenge IFRS implementation in China, because high quality auditing is one of the efficient enforcement mechanisms for the rigorous and consistent application of IFRS (Hail *et al*., 2010a).

Second, Chinese accounting professionals are considered as lack of the necessary education and experience to consistently interpret IFRS and make appropriate judgments (World Bank, 2009; ICAS, 2010; Chen, 2015). Chinese accounting professionals have been accustomed to the rules-based approach during a long period of education and practice under an accounting system with detailed regulations (Li, Y., 2011). Actually, after the establishment and issuance of the new set of Chinese GAAP in 2006, the application of more principles-based accounting standards modeled on IFRS was one of the main concerns of the Chinese regulatory authorities. To ensure the consistent implementation of principles-based accounting standards by preparers of financial statements and CPAs, the MOF offered a series of guidelines (*yingyongzhinan*), interpretations (*jieshi*), and explications (*jiangjie*).

Although IFRS tend to limit guidance for applying the general principles to particular transactions and economic events and encourage the application of professional judgments (Doupnik and Perera, 2012), considering the current Chinese professional environment, detailed guidance and interpretations of principles-based accounting standards are indispensable for the consistent implementation of IFRS in China (Li, Y., 2011). The MOF has been concerned about that IFRS without greater specificity and more guidance would encounter practical problems in China.

Furthermore, the MOF recognizes that IFRS give financial reporting preparers broad discretion because the application of the standards involves considerable judgments and estimations. The MOF is concerned about that the broad discretion may lead to unintended consequences in Chinese-specific context. For example, fair value measurement relies on managers' private information and involves an assessment of the future, may leading to subjective biases, and thus unreliable financial information (Liu, 2007, 2011b). To make things worse, Chinese CPAs may not be able to effectively audit fair value measurement to confirm the appropriateness of preparers' estimations and moderate subjective biases (Li *et al*., 2012; Yang *et al*., 2012).

5.4 Individual Environment

The individual environment refers to accounting policy choices made by individuals and comprises the whole setting in which individuals lobby accounting standard setters and use accounting numbers to pursue respective interests. The accounting standard setter in China is a public sector, the MOF. According to the *Accounting Law*, the MOF is entrusted with the only authority to establish accounting standards that are mandatorily applied by all enterprises in China.

The MOF, between 2001 and 2004, showed little interest and hesitation to converge Chinese GAAP with or adopt IFRS, although convergence with or adoption of IFRS gained momentum across the global after 2000. This situation changed along with the personnel replacement in the MOF (Camfferman and Zeff, 2015). Wang Jun, at the end of 2004, replaced Feng Shuping to be responsible for establishing Chinese GAAP. Wang Jun encouraged the establishment of a new set of Chinese GAAP, aiming at promoting the convergence with IFRS.

While crafting the new set of Chinese GAAP during the early 2005 and the early 2006, the MOF invited a team of specialists from the IASB for technical assistance to achieve convergence with IFRS (Camfferman and Zeff, 2015). During the initial stage of the collaboration, the IASB held a strong position that convergence means full adoption of IFRS word for word (Wang, 2006b). On the other hand, Wang Jun contended that accounting standards should consider national contextual factors such as the economic environment, legal system, cultural tradition, enforcement system and professional competence (Wang, J., 2005). Finally, Wang Jun convinced Sir David Tweedie, the former Chairman of the IASB (2001-2011), that direct adoption of IFRS (either mandatory or voluntary) was infeasible in China because of specific Chinese accounting environment.

After negotiations, both accounting standard setters took a step back. The MOF made significant revisions to the initial draft of Chinese GAAP according to suggestions from the IASB' specialists to eliminate major differences between Chinese GAAP and IFRS. On the other hand, the IASB accepted that "how to converge with IFRS is a matter for China to determine" (CASC and IASB, 2005), and acknowledged that the new set of Chinese GAAP had achieved "substantial convergence" with IFRS (IASB, 2006), although evident gaps between Chinese GAAP and IFRS still existed (Camfferman and Zeff, 2015).

Wang Jun accepted that economic globalization and accounting convergence are irresistible trends. He, however, opposed IFRS adoption and argued that Chinese-specific contextual factors should be considered. Furthermore, Wang Jun insisted that the convergence of accounting standards should be bidirectional. Specifically, Wang Jun suggested that the IASB should take account of China's specific accounting environment, as well as those of other developing, emerging, and transitional economies rather than imposing unidirectional IFRS adoption (Wang, J., 2005).

After Wang Jun's promotion to the Vice Minister of the MOF in 2005, his decision has been thoroughly implemented by his successors, Liu Yuting and Yang Min, former Director Generals of the Accounting Regulatory Department within the MOF. Both of them argued that IFRS will be more applicable in emerging and transitional economies only if the IASB considers contextual factors in these economies (Liu, 2009; Yang *et al*., 2011).

Particularly, Yang Min led a project team within the MOF to study the application of fair value measurement in countries with emerging market-oriented economies, and concluded several practical problems. For example, the project team led by Yang Min reported:

> *Although many product markets exist in emerging economies, these markets lack enough depth and liquidity. For example, relatively inactive markets include inter-bank bond market, treasury bonds market, credit default swap market, the market for loan assets, and the real estate market. The lack of market depth results in price manipulation by market participators and the increase of non-orderly transactions. Furthermore, for items such as*

investment properties measured at fair values, non-performing loans held by asset management companies, and financial instruments needing credit risk adjustments, their valuations are difficult because of the lack of observable market inputs (Yang *et al*., 2012, p.6).

Moreover, the MOF argued that Chinese GAAP reflect economic reality of transactions in China's context better than IFRS do in some cases. One example is the accounting standard for business combinations, for which the MOF requires the pooling of interests method for business combinations under common control, while the IASB requires the application of the purchase method for all business combinations. The MOF recognized that a large portion of business combinations in China are the ones under common control, and their nature is reorganizations among intra-group entities, rather than takeovers of acquired companies by acquiring companies through capital markets (Pan, 2002; Huang *et al.*, 2004; Biondi and Zhang, 2007; Baker *et al*., 2010; Yang *et al.*, 2011). Thus, the MOF required the application of the pooling of interests approach, prohibiting the revaluation of assets and liabilities by using fair value measurement and the recognition of goodwill. The MOF has no plan to eliminate the pooling of interests approach in order to achieve greater convergence with IFRS. Instead, the MOF suggested that the IASB should revise existing IFRS (specifically, IFRS 3 *Business Combinations*) or set a new accounting standard to regulate business combinations under common control (Liu, 2011a).

The example of the accounting standard for business combinations shows that the MOF has no plan to uncritically adopt IFRS. On the contrary, the MOF has been trying to force the IASB to reflect Chinese-specific accounting issues in IFRS. Liu Yuting stated that "the fundamental reason for why China cannot directly adopt IFRS is that the establishment and main revisions of IFRS have not well considered actual conditions in China and other emerging market economies" (Liu, 2011a). He argued that only if the IASB does so, IFRS will "achieve high-quality, authority, and worldwide legalization in deed" (Liu, 2011b, p.14).

Various stakeholders in China can express views and opinions in the process of setting Chinese GAAP. Major lobby groups include the CSRC, the State-owned Assets Supervision and Administration Commission (SASAC), the China Banking Regulatory Commission (CBRC), the China Insurance Regulatory Commission (CIRC) and the State Administration of Taxation (SAT), SOEs, state-owned banks, stock exchanges, auditing firms and accounting academics (MOF, 2011b). Among them, regulators such as the CSRC, the CBRC, the CIRC, the SASAC and the SAT are the strongest lobby groups because they are involved in not only the establishment of Chinese GAAP but also the enforcement of accounting standards, providing implementation guidance and interpretations of accounting standards, and supervising the implementation in enterprises, financial institutions and auditing firms (Yu, 2016).

These regulators, especially the CSRC, tend toward conservative accounting and oppose the extensive application of fair value measurement. For example, Li Xiaoxue, former committee member for Discipline Inspection within the CSRC, stated:

> *Considering the features of China's market economy, the CSRC hopes that [a listed company] provides financial information reflecting its ability to continue as a going concern, rather than gains or losses from prices fluctuation of short-term financial assets* (Li, X., 2011, p.14).

Moreover, Jia Wenqin, the Chief Accountant and the head of the Accounting Department within the CSRC, stated:

> *Considering the features of China's current market economy, to maintain the country's financial stability, [we should] moderately use fair value measurement. Currently, economic development in our country is still largely dependent on the real economy rather than the "fictitious" economy.*[22] *Additionally, the market economy has not yet fully developed in China. There is a lack of active markets in some areas, so the application of fair value measurement relies largely on subjective judgments and estimations of managers, leading to some flaws in reliability. Moreover, the*

application of fair value measurement is likely to aggravate the fluctuation of operating performance, especially for banks financial institutions that hold a large amount of financial assets. Considering current economic environment and financial stability in China, it is necessary to have a comprehensive understanding of the constraints on the application of fair value measurement in China, and take advantage of respective strength of historical cost and fair value measurement… [I] suggest that China's accounting standard setter should weight the pros and cons [caused by further convergence with IFRS] and cautiously make policies that adapt to real economic environment in our country, and should not pursue convergence with IFRS at the expense of the decline in accounting information quality reported by Chinese enterprises (Jia, 2010, p.9).

5.5 Accounting Environment

The accounting environment includes existing and desirable financial reporting regulations and practices that affect, and are affected by the other slices, including societal, organizational, professional and individual slices. With establishing a centrally-planned economy in the 1950s, the Chinese government adopted a Soviet-style accounting system. This system was mainly characterized as rules-based and taxation-oriented. The MOF provided detailed accounting regulations such as the depreciable rate, and allowed almost no professional judgments (Li, Y., 2011). Additionally, accounting treatments were required to be in accordance with tax regulations (Feng, 1999a). The MOF required all Chinese SOEs to apply this accounting system until the early 1990s.

Table 5.8 summarizes the process of the convergence of Chinese GAAP toward IFRS. Indeed, the MOF, since the early of 1980s, progressively converged Chinese GAAP with IFRS in order to address the internal and external pressures arising from China's fast growing market economy and the increasing integration of Chinese economy into the global economic system, such as the global trade and financial markets (Baker *et al*., 2010; Peng and Bewley, 2010).

Table 5.8: The Process of the Convergence with IFRS in China

The establishment and application of Chinese GAAP						
	1950s-1984	1985	1992	1993	2002	2006
Accounting regulations	Soviet-style accounting system	strict historical cost accounting	strict historical cost accounting	modified historical cost accounting[note1]	modified historical cost accounting[note2]	modified historical cost accounting[note3]
Scope of application	all enterprises in China	enterprises with foreign investment	all enterprises in China	listed companies	all enterprises in China	listed companies since 2007 all large and medium-sized enterprises since 2008
The application of fair value measurement in Chinese GAAP						
				1998	2001	2006
				introduced fair value measurement the first time	eliminated fair value measurement	re-introduced fair value measurement

Source: prepared by the author.
Note 1: involving lower of cost or market method (Tsunogaya *et al*., 2011, p.19).
Note 2: involving impairment accounting for long-lived assets (Tsunogaya *et al*., 2011, p.19).
Note 3: involving partial adoption of fair value measurement for financial assets (Tsunogaya *et al*., 2011, p.19).

Specifically, after "Reform and Opening Up" policy in 1978, foreign investment increased rapidly and contributed significantly to the Chinese economy development. The MOF, in 1985, introduced a historical cost accounting system to Sino-foreign joint ventures (*zhongwai hezi jingying qiye*) to meet the information needs of foreign investors (Tokuga and Wang, 2005; Ezzamel *et al*., 2007). With the introduction of market mechanisms into Chinese SOEs, the Soviet-style accounting system was criticized for not meeting the information needs of outside investors and creditors (Yang, 1988). Then, the MOF, in 1992, repealed the Soviet-style accounting system and required all Chinese enterprises to apply the historical cost accounting system. Afterward, with the development of Chinese capital markets since 1990, the MOF gradually introduced a so-called modified historical cost accounting[23] into Chinese listed companies to meet the financial information needs of investors in capital markets. China joined in the World Trade Organization (WTO) in 2001. This required the Chinese government to further introduce institutions compatible with market economy. In the accounting dominion, the MOF, in 2002, required all enterprises in China to apply the modified historical cost accounting. During this period, the modified historical cost accounting system dominated most national GAAPs and international accounting standards (Tsunogaya *et al*., 2011).

By introducing the modified historical cost accounting, the MOF intended to make financial statements illustrate "the economic and monetary process of the firm as an entity and a going concern, focusing on the incomes generated during the reference accounting period" (Biondi and Zhang, 2007, p.703). Thus, the MOF adopted some internationally accepted accounting principles such as the accrual basis, matching between revenues and related expenses, and valuation on a historical cost basis (MOF, 1992).

Importantly, as a result of convergence with international accounting standards, the MOF adopted fair value measurement in the late 1990s. The MOF issued accounting standards for *Debt Restructurings* and *Non-monetary Transactions* in 1998 and 1999, respectively, and required enterprises to recognize the differences between the carrying values and the fair values of the exchanged assets during debt restructurings and non-monetary transactions as current profits.

Many studies found that during the implementation of the two accounting standards, a number of Chinese listed companies abused the fair values in debt restructurings and non-monetary transactions to overstate reported profits (Wang, J. X., 2005; Xie *et al*., 2008; He *et al*., 2012). Feng Shuping, former Director General of the Accounting Regulatory Department within the MOF and former Assistant Minister of the MOF, pointed out that one practical problem with fair value measurement was "how to determine the fair values of exchanged non-monetary assets. If the fair values cannot be correctly determined, it is possible that enterprises abuse debt restructuring transactions to window-dress their financial statements" (Feng, 1999b, p.44). To prevent potential earnings manipulation through abusing fair value measurement, the MOF, in 2001, revised the accounting standards for *Debt Restructurings* and *Non-monetary Transactions* and required Chinese enterprises to value the exchanged assets on the carrying values rather than on the fair values. As such, during 2001 and 2005, the MOF eliminated fair value measurement application in Chinese accounting system.[24]

The IASB, on the contrary, showed an increasing preference for fair value accounting during the same period. Especially, the IASB's movement toward fair value accounting was strengthened mainly by the influence of the FASB after singing the *Norwalk Agreement* in 2002 between the two accounting standard setters (Whittington, 2008). The FASB and the IASB had used political rhetoric such as "fair," "transparent," and "relevant" to promote the extensive application of fair value measurement in U.S. GAAP and IFRS (Biondi and Suzuki, 2007; Tsunogaya *et al*., 2011). As fair value accounting and global convergence of IFRS gained momentum, the MOF was under strong exogenous pressures to accept fair value as a measurement attribute. As a respond to the pressures, the MOF re-introduced fair value measurement in the new set of Chinese GAAP issued in 2006.

Although Chinese GAAP moved significantly toward fair value accounting in a stream of global accounting convergence, the MOF imposed tight constraints on the application of fair value measurement (Biondi and Zhang, 2007; Baker *et al*., 2010). Indeed, the *Basic Standard* (*jibenzhunze*), which is considered as the conceptual framework of Chinese GAAP (Biondi and Zhang, 2007), introduced fair value as one of acceptable measurement attributes. It, however, used the historical cost as the principle measurement attribute, and required fair value measurement only for certain items such as marketable securities. Table 5.9 illustrates some significant differences between Chinese GAAP and IFRS in terms of fair value measurement as follows.

Table 5.9: The Application of Fair Value Measurement in Chinese GAAP and IFRS

Regulations	**Chinese GAAP (ASBE)**	**Fair value measurement**	**IFRS**	**Fair value measurement**
Measurement of fixed assets and intangible assets after recognition	Allow only cost model[note1] ASBE 4: *Fixed Assets*, ASBE 6: *Intangible Assets*	N/A	Permit choice between cost and revaluation model[note2] IAS 16: *Property, Plant and Equipment*, IAS 38: *Intangible Assets*	Level 1, Level 2, Level 3
Measurement of biological assets after recognition	Principle: historical cost; Exception: fair value ASBE 5: *Biological Assets*	Level 1, Level 2, Level 3	Principle: fair value; Exception: historical cost IAS 41: *Agriculture*	Level 1, Level 2, Level 3
Measurement of investment properties after recognition	Principle: historical cost; Exception: fair value; Prohibit the change from fair value model to cost model ASBE 3: *Investment Property*	Only Level 1 and Level 2 are permitted	Either fair value [note3] or cost model; Permit the change from one model to the other only if the change results in a more relevant presentation IAS 40: *Investment Property*	Level 1, Level 2, Level 3
Reversal of impairment losses	Prohibit the reversal of impairment losses for all assets ASBE 8: *Impairment*	N/A	Require the reversal of impairment losses for every asset except goodwill IAS 36: *Impairment of Assets*	N/A

Source: prepared by the author using data from MOF (2006b, 2006c, 2014a, 2014b, 2014c, 2014d, 2014e, 2014f, 2014g, 2014h) and IASB (2016b, 2016d, 2016e, 2016f, 2016g).

Note 1: Cost model means measuring assets at their costs less any accumulated depreciation and any accumulated impairment losses.

Note 2: Revaluation model means measuring assets at their fair values at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses.

Note 3: Fair value model means measuring assets at their fair values without depreciation or impairment requirements.

(1) Chinese standards for fixed assets and intangible assets adopt the historical cost model, requiring the measurement of these assets at their depreciated acquisition

costs, while IFRS (e.g. IAS 16 and IAS 38) allow a revaluation model that reflects changes in fair value.

(2) Chinese GAAP require enterprises to measure a biological asset on initial recognition at its cost, and require measurement after recognition at its fair value only when the fair value can be measured reliably on a continuing basis, while IAS 41 requires enterprises to measure a biological asset on initial recognition and at the end of each reporting period at its fair value less costs to sell.[25]

(3) Chinese GAAP prohibit the use of unobservable inputs to measure the fair value of investment properties, while IAS 40 allows Level 3 inputs[26] to measure the fair value of investment properties. Additionally, Chinese GAAP prohibit a change from the fair value model to the cost model for subsequent measurement of investment properties, while IAS 40 allows such a change if the change results in a more appropriate presentation.

(4) Chinese GAAP prohibit the reversal of impairment losses for all assets, while IAS 36 requires the reversal of impairment losses for every asset except goodwill.

The MOF has been concerned about the extensive application of fair value measurement, and allows the application only when the fair values of items are reliably measurable on a continuing basis (Liu, 2007, 2011a, 2011b). The main reasons for the limited application of fair value measurement can be summarized as follows.

(1) The manufacturing sector has a central place in the Chinese economy, and manufacturing companies have a relatively low proportion of financial assets in their total assets. For these companies, financial information users, including investors, anticipate enterprises' future operating performance largely based on realized incomes reported under historical cost accounting. Therefore, the demand for financial information based on fair value measurement is relatively weak in China (Jia, 2010; FSA, 2012).

(2) As the market economy in China is undeveloped, directly observable prices in active markets for most assets and liabilities, especially non-financial assets and liabilities, are not available (Feng, 2004; Peng and Bewley, 2010; Liu, 2011b). Therefore, if the

MOF allows the extensive application of fair value measurement in China, preparers of financial reporting may apply Level 3 inputs and use subjective estimations to measure the fair values of most assets and liabilities. This may cause subjective biases, and thus unreliable financial information (Xie, 2006; Penman, 2007; Liu, 2007).

(3) Most auditors in China lack the necessary trainings and experience to apply fair value measurement. Therefore, they may be unable to effectively audit fair value measurement to confirm the appropriateness of preparers' estimations (Li *et al*., 2012; Yang *et al*., 2012). This means that auditing in China may be unable to moderate subjective biases.

(4) Given that some Chinese listed companies abused fair value measurement to inflate earnings during 1998 and 2000, the MOF has been concerned about the potential opportunistic uses. To reduce opportunities for earnings manipulation, the MOF imposed restrictions to the application of fair value measurement, such as prohibiting the change from a fair value model to a cost model once an enterprise applied a fair value model to measure investment properties, and banning the reversal of impairment losses for all assets once impairment losses were recognized in prior fiscal periods (Liu, 2011b).

These reasons provide evidence that Chinese-specific contextual factors such as economic development, professional training, and organizational structure may cause inconsistent application of fair value measurement in China. Furthermore, this fact provides a rationale for the MOF's refusal to directly adopt IFRS, which include extensive application of fair value measurement.

Chapter 6

Other Factors Related to the IFRS Implementation in China

6.1 Endorsement

According to the *Accounting Law* (article 7), the National People's Congress of China[27] has delegated Chinese accounting standards setting authority to the MOF. Since the IASB is a private standard setter without the power to issue legally binding standards, IFRS are not simply applied in each country or region as issued by the IASB and need to be endorsed by local authoritative agencies. Actually, several countries and regional entities such as Japan and the EU, have applied an endorsement mechanism for existing IFRS and future amendments of existing IFRS or the creation of new IFRS. An endorsement mechanism had been used as a safeguard against undue foreign influence and to preserve the local legislator's veto rights.[28] Thus, it is can be expected that if the MOF directly adopts IFRS, it will be likely to apply an endorsement mechanism to create "IFRS as endorsed by the MOF".

As discussed in Chapter 5, the Chinese context has several prominent features such as the high weight of the secondary sector in China's economy, the heavy dependence on bank loans for financing and the deficiency in accounting professionals. Chinese reporting system has evolved in concert with these features. For instance, Chinese GAAP take the historical cost as the principle measurement attribute and restrict the extensive application of fair value measurement. As such, even if the MOF decides to adopt IFRS, it is unlikely that the MOF will permit or require Chinese companies to apply "IFRS as issued by the IASB". The MOF will be likely to make modifications and exclusions of IFRS to accommodate Chinese interests. For example, although the IASB prohibits the pooling of interests method for business combinations, Yang Min, former Director General of the Accounting Regulatory Department, recognized that this method is necessary for business combinations in China, and stated:

> *In China, a large number of business combinations happened within the same enterprise groups. These are business combinations under common control, regarding which IFRS have not yet provided clear regulations. Supposing that we accept the "direct adoption" approach, this will result into a gap in accounting standard, leading to the absence of regulations for such accounting practices. Even if we wait for the IASB to establish a new standard or revise the extant standard for these transactions, we would need to wait for a long time because of the due process, such as planning the project, research, public consultation, voting and publishing the standard. This is not conducive to the improvement in accounting practices and financial information of Chinese enterprises* (Yang *et al*., 2011, p.15).

Moreover, Liu Yuting, former Director General of the Accounting Regulatory Department, pointed out that Chinese GAAP excluded accounting standards for employee benefits and financial reporting in hyperinflationary economies. That is because employee benefits transactions are not common in China and hyperinflation is not expected to occur in an economy under the strong control of the Chinese government (Liu, 2007). Even if the MOF decides to directly adopt IFRS, it will be likely to add certain accounting regulations exempt from IFRS or exclude certain IFRS regulations in the Chinese-specific version of IFRS during an endorsement process. These deliberate modifications would lead to a national set of IFRS in China. Such a regionalization of IFRS opposes the IASB's intended goal of facilitating cross-border comparability by establishing a single set of global accounting standards.

Moreover, if the MOF adopts IFRS, the endorsement process potentially leads to a time lag between the release of standards or interpretations by the IASB and corresponding regulations in "IFRS as endorsed by the MOF". The time lag may be up to years. For example, the IASB established IFRS 13 and made it effective for annual periods beginning on or after January 1, 2013. The MOF incorporated IFRS 13 into Chinese GAAP, and issued the accounting standard for *Fair Value Measurement* on January 26, 2014, and required its application in Chinese listed companies since July 1, 2014. The time lag between the effective dates of the accounting standard for fair value measurement in IFRS and Chinese GAAP was one and half years. The time lag between the release of a standard by the IASB and its endorsement by the MOF is likely to hinder the comparability of financial reporting between enterprises in China and firms in other IFRS-adopting countries. That is because the MOF will be unlikely to permit Chinese enterprises to voluntarily apply an issued standard before endorsement while firms in other countries may be applying the standard already.

6.2 Interpretation of IFRS

Chinese accounting professionals have experienced merely 30 years of development and most of them have been accustomed to the rules-based approach during a long period of education and practice under Chinese accounting system with detailed regulations. Thus, Chinese accounting professionals are considered as lack of the necessary education and experience to make consistent interpretations and appropriate judgments under principles-based accounting standards (World Bank, 2009; ICAS, 2010; Chen, 2015). With such professional environment, precise interpretations and application guidance are essential for the consistent implementation of IFRS in China (Li, Y., 2011). Actually, accountants in Chinese enterprises and auditors in accounting firms have been largely relying on guidance provided by the MOF, such as interpretations (*jieshi*) and explications (*jiangjie*). This caused that current Chinese GAAP provide more specific rules than IFRS do. Despite this, Li Xiaoxue, former committee member for Discipline Inspection within the CSRC, pointed out that the MOF has not provided adequate interpretations to Chinese GAAP and suggested that the MOF should accelerate the development of interpretations. Moreover, Li Xiaoxue suggested that regulators of Chinese financial sector, such as the CSRC and the CBRC, should also provide detailed guidance to accounting standards implementation. Li Xiaoxue stated:

> *The interpretation mechanism of accounting standards cannot meet the needs of financial reporting preparers and regulators [in China]. The MOF had claimed continuing convergence with IFRS. Thus, it consults regularly*

> *with the IASB when develops or modifies the implementation guidance. This leads to a long period for issuing the implementation guidance, and in some cases, the MOF and the IASB cannot come at definitive conclusions. On the other hand, Chinese capital markets are in an emerging and transitional period. In these markets, new economic events and transactions have been continuously emerging. There is an urgent need for uniform standards to regulate new economic events and transactions. ... Recent modifications of IFRS, such as accounting standards for the impairment of financial instruments and lease, were characterized as theoretical and relatively lack of operability. ... In order to regulate the [accounting standards] implementation and improve the quality and comparability of [financial] information, regulators of the financial sector [in China] need to consider how to provide detailed implementation guidance according to the actual situations in supervised [business] entities* (Li, X., 2011, pp.13-14).

Considering Chinese contextual factors, such as the incompetence of accounting professionals who are skilled in making appropriate interpretations and judgments of principles-based accounting standards and political pressures from the regulator of Chinese capital markets for implementation guidance, the MOF will be likely to provide more precise guidelines such as bright-line thresholds and examples, even if it directly adopts IFRS (Li, Y., 2011). Moreover, Chinese enterprises will be likely to rely on precise guidelines offered by the MOF in cases for which IFRS have gaps or are too vague.

Agoglia *et al*. (2011) documented the effect of accounting standard precision on financial statement preparers' judgments. Specifically, their results showed that financial statement preparers were less likely to report aggressively (in Agoglia *et al*. (2011), preparers are more likely to capitalize the lease) when applying a less precise financial reporting standard (in Agoglia *et al*. (2011), that is the one with more principles-based lease classification criteria) than when applying a more precise standard (in Agoglia *et al*. (2011), that is the one with more rules-based lease classification criteria). Given that the MOF is expected to provide more precise guidance than the IASB, accounting professionals in China will be likely to make different judgments from their counterparties in other IFRS-adopting countries, even if China directly adopts IFRS.

Importantly, the MOF has adopted a perspective focusing on the financial and productive process generated by the whole entity, which leads to matching-based representation and historical cost valuation. This is different from the IASB's fair value perspective focusing on the net worth of the enterprise as the residual to the shareholders and the accounting representation of the market-based value of the firm (Biondi and Zhang, 2007). Thus, the MOF is likely to offer interpretations and implementation guidelines that lead Chinese enterprises to make different accounting treatments from IFRS-applying firms in other countries do even for the same transactions and economic events. For example, although the MOF adopted the same accounting treatments with IFRS in current Chinese GAAP and allowed enterprises to choose cost model or fair value model for the measurement of certain assets after recognition, such as investment properties and biological assets, the MOF "required enterprises to strictly limit the application of fair value measurement during the implementation of accounting standards" (Liu, 2011b, p.11). This evidence shows that even if China directly adopts IFRS, the MOF will be likely to provide interpretations and guidelines that are geared towards the local adaptation of IFRS, leading to differences in accounting practices between China and other IFRS-applying countries.

Additionally, Chinese accounting professionals may be faced with the challenges to interpret IFRS in a consistent manner as do counterparties in Anglo-American countries (World Bank, 2009). Especially, principles-based IFRS contain numerous verbal probability expressions such as "sufficient certainty", "reasonable assurance" and "no longer probable" (Doupnik and Richter, 2004). These uncertainty and probability expressions need to be interpreted appropriately and consistently to enhance comparability of financial reporting worldwide (Chand *et al*., 2010). However, several previous studies (e.g. Doupnik and Richter, 2003, 2004; Doupnik and Riccio, 2006; Chand *et al*., 2010) documented the effects of country-specific factors, such as the national culture and accounting professionals' familiarity with accounting standards in IFRS,[29] on accountants' interpretations of IFRS. Particularly, Chand *et al.* (2012) found that Chinese students showed greater conservatism and secrecy than Australian students in assigning probabilities to uncertainty expressions in IFRS. Furthermore, Chand *et al.* (2012) showed that similar secondary and tertiary education could not mitigate the effects of the national culture on professional judgments of Australian (Anglo-Celtic) students and Chinese Australian students (who were born in China and migrated to Australia to complete their secondary and tertiary education). Even if the MOF adopts IFRS, it is expected that unique Chinese national culture, such as long-term orientation and conservative virtues, will affect accounting professionals' interpretations of IFRS, leading to different financial reporting between Chinese enterprises and firms in Anglo-American countries.

6.3 Cost of IFRS Implementation

The MOF requires Chinese enterprises to prepare both of consolidated and non-consolidated financial statements in accordance with the new set of Chinese GAAP. The MOF considers that a single set of accounting standards for both consolidated and non-consolidated financial statements can avoid maintaining two sets of accounts system and reduce enterprises' cost to prepare financial reporting (FSA, 2012). Actually, non-consolidated financial statements are important for Chinese enterprises. First, the CSRC required Chinese listed companies to conduct profit distribution based on non-consolidated financial statements (CSRC, 2008b).[30] Second, most Chinese enterprises calculate the taxable income based on the accounting profits reported in the non-consolidated financial statements. Traditionally in China, there has been a close relationship between taxation and accounting, and the calculation of taxable income has been a major purpose of accounting for most Chinese enterprises, especially small and medium-sized ones (Doupnik and Perera, 2012). Moreover, the close link has been specified by the *Enterprise Income Tax Law*, which defines the financial statements as the basis for calculating taxable income and requires enterprises to submit financial statements to taxation authorities along with tax returns (article 21, article 54).

Considering that the *Enterprise Income Tax Law* uses historical cost as tax basis for all assets (article 56), if the MOF permits or requires Chinese enterprises to prepare both consolidated and non-consolidated financial statements in accordance with IFRS (hereinafter, "uniformity approach"), the divergences between accounting regulations and taxation rules would be enlarged, leading to the increase in adjustment costs of firms from accounting profits to taxable income (Dai *et al*., 2005; Song, 2013). On the other hand, if the MOF permits or requires IFRS only for consolidated financial statements and requires Chinese GAAP for non-consolidated financial statements (hereinafter, "separation approach"), Chinese enterprises should have to prepare two sets of financial statements, one is under IFRS mainly for the financial reporting purpose and the other is under Chinese GAAP mainly for the taxation purpose and profit distribution. This "separation approach" would require skilled personnel who are competent to prepare financial statements under IFRS as well as Chinese GAAP. Considering the increasing complexity of both sets of accounting standards, Chinese firms should need to recruit new employees or re-train existing employees. The costs to employ or re-train specialized staffs would be a high financial burden for companies, especially for small and medium-sized firms. The implementation costs led by the "separation approach" had been demonstrated by the case of Germany (see Hellmann *et al*., 2010, p.113). As such, either the "uniformity approach" or the "separation approach" would lead to high implementation costs for Chinese enterprises.

Additionally, the adoption of IFRS in China, either mandatory or voluntary, would largely increase the enforcement and regulation costs of regulators such as the MOF and the CSRC. First, even if the MOF adopts IFRS, it is expected that the MOF would continue to weigh in on the implementation of IFRS. For example, considering the Chinese-specific context, such as the insufficiency in qualified accounting professionals who are competent to make appropriate interpretations of IFRS and judgments, the MOF would have to spend considerable budgetary and personal resources to provide interpretations and precise implementation guidance for principles-based accounting standards (Li, Y., 2011).

Second, the MOF and the CSRC supervise the implementation of accounting standards in Chinese enterprises and the auditing of financial statements.[31] The effectiveness of the enforcement by the MOF and the CSRC largely depends on their funding, research capability and officials' professional knowledge. Actually, even for the new set of Chinese GAAP, developing human capacities for supervising accounting standards implementation has been one of urgent issues for the regulators. For example, the World Bank pointed out that in order to improve the review of companies' financial statements as well as the review of accounting firms and CPAs' auditing practices, regulators in China, such as the MOF and the CSRC, need to recruit more technically qualified personnels who have the experience related with accounting and auditing standards implementation (World Bank, 2009). If the MOF adopts IFRS, the MOF and the CSRC would have to recruit expertized staffs who have the practical experience related with IFRS implementation and auditing of IFRS-based financial statements. This would be a big challenge, because only a small number of Chinese accounting professionals have adequate exposure to IFRS-related reporting and auditing practices (Wang, 2012).

Third, the CSRC anticipates that extensive application of fair value measurement would lead to a significant increase in the costs for supervising financial reporting of listed companies. For example, Jia Wenqin, the Chief Accountant and the head of the Accounting Department within the CSRC, stated:

> *It is foreseeable that if fair value measurement is applied in a wide range in China as in the United States, this would lead to large fluctuation in companies' net assets and net profits in different accounting periods and may provide more opportunities to companies for earnings manipulation by using fair values. This would significantly increase our supervision costs and bring unprecedented challenges to regulation* (Jia, 2010, p.9).

Moreover, the direct adoption of IFRS would bring high financial burden for accounting firms, especially for Chinese domestic ones. Table 6.1 describes the distribution of expenditure for 2013FY annual reports auditing of Chinese listed companies. Table 6.1 shows that the major proportion (1,854 of 2,314) of Chinese domestic accounting firms' clients paid audit fees under 1 million RMB. These data show that the main clients of most domestic accounting firms were relatively small and medium-sized enterprises. Hence, most domestic accounting firms may not have the experience in addressing complex accounting practices such as estimating fair values of certain assets and liabilities. Chand *et al*. (2010) documented that appropriate training and adequate exposure to new accounting standards are essential to proficient and consistent interpretation and application of the new accounting standards. The direct adoption of IFRS in China requires domestic accounting firms to foster IFRS-specific capabilities with efforts such as improving training of CPAs and furthering CPAs' exposure to IFRS-related practices. This would be a great challenge for Chinese domestic accounting firms, because most of them have no experience in auditing IFRS-based financial statements. Thus, they have to spend huge costs to recruit new employees and re-train existing employees, and even have to seek networks with international accounting firms to gain resources (e.g. procedure manuals, application guidance, and training) on the IFRS implementation tasks (Wang, 2012).

Table 6.1 Chinese Listed Companies' Audit Expenditure for 2013FY Annual Reports

Audit Fee (thousand RMB)	Number of companies	Proportion (%)	Number of the Big 4's clients	Share of the Big 4 (%)	Number of domestic accounting firms' clients	Share of domestic accounting firms (%)
Over 100,000 (including 100,000)	4	0.16	4	100.00	0	0.00
50,000-100,000	4	0.16	4	100.00	0	0.00
10,000-50,000	21	0.85	19	90.48	2	9.52
5,000-10,000	32	1.30	25	78.13	7	21.87
1,000-5,000	534	21.64	83	15.54	451	84.46
500-1,000	1,258	50.97	18	1.43	1,240	98.57
Below 500	615	24.92	1	0.16	614	99.84
Sum	2,468	100.00	154		2,314	

Source: *An Analysis of Auditing of Listed Companies' 2013FY Annual Reports* (CSRC, 2014).

Notes: 40 accounting firms, including the Big 4 and 36 domestic accounting firms, conducted auditing of Chinese listed companies' 2013FY annual reports.

The Big 4 includes Deloitte Touche Tohmatsu, KPMG, PricewaterhouseCoopers and Ernst and Young.

Moreover, Table 6.1 shows that the major part of Chinese listed companies (2,314 of 2,468) have been audited by domestic accounting firms. Thus, Chinese domestic accounting firms'

IFRS-specific capabilities would largely affect the entire auditing quality and the consistent implementation of IFRS in China.

6.4 Translation of IFRS

Literal translation of some accounting concepts and terms in IFRS is difficult because full equivalence in translation between English and Mandarin Chinese is rare. When an exact equivalent accounting terminology to the concept in IFRS does not exist in Mandarin Chinese, translators tend to use the nearest equivalent. This may "lead to a blurring of meaning or loss of significant differences in the concepts" (Evans, 2004, p.211), because the nearest equivalent may be already applied in the Chinese context and defined differently from the concept in IFRS. For example, there is no exact equivalent terminology in Chinese GAAP to the accounting concept of "income" in IFRS, thus the China Accounting Standards Commission (CASC) [32] within the MOF used the nearest terminology and translated "income" into Mandarin Chinese as "*shouyi*" (CASC, 2013, p.10). The terminology of "*shouyi*" in Chinese GAAP is traditionally equivalent to profit or loss. For instance, "earnings per share" was translated into Mandarin Chinese as "*meigu* (means per share) *shouyi* (means earnings)" (MOF, 2006b), and the concept of "earnings" is defined as "profit or loss from continuing operations attributable to the parent entity" and "profit or loss attributable to the parent entity" (IASB, 2016c, para.12). On the contrary, as the IASB stated that "an entity may use the term 'net income' to describe profit or loss" (IASB, 2016a, para.8), "income" does not necessarily mean a net amount deducting expenses, namely profit or loss. Thus, "*shouyi*" is not the exact Chinese equivalent to "income". This example provides an evidence that during the translation process from English into Mandarin Chinese, translators may use the accounting terminologies that have already linked with other concepts or ideas in Chinese GAAP. This may lead the users of Mandarin Chinese-version of IFRS, such as preparers of financial reporting, auditors, investors and regulators in China, to understand some important accounting concepts in a different way from the users of English-version of IFRS.

In addition to the misunderstandings caused by literal translation, users of Mandarin Chinese-version of IFRS may make different interpretations of an accounting concept from the users of English-version of IFRS because the word used in translation may correspond to different connotations in Chinese context. For example, Pan *et al*. (2015) found that Chinese students made significantly different interpretations of the principle of "control" and consolidation judgments when they were given the research instruments in English from when they were offered the same research instruments translated into Mandarin Chinese. Pan *et al*. (2015) further found that Chinese students' interpretations of "control" and their consolidation judgments were largely influenced by the Mandarin Chinese translation of "control" because the word used in translation, namely "*kongzhi*", has a connotation of the Chinese government's "invisible power" over economy and accounting.

Besides translating IFRS into various national languages word for word, adding precise guidance to IFRS by national accounting standards setters is another challenge for the global implementation of a single set of accounting standards. IFRS contain broad principles and 'uncertainty expressions' with the aim to guide judgments made in practice. For example, IAS 17 *Leases* adopted "major part" and "substantially all"[33] to prescribe the criteria for the classification of a lease as operating or capital lease. The MOF developed the accounting standard for leases substantially by adopting IAS 17, and included "for the major part of the economic life" and "substantially all of the fair value of the leased assets" criteria. The MOF translated "major part" into "*dabufen*" and "substantially all" into "*jihu xiangdangyu*". The MOF also provided guidance for the interpretation of "*dabufen*" and "*jihu xiangdangyu*" as follows: "generally, '*dabufen*' should be above 75% (including 75%) … '*jihu xiangdangyu*' should be above 90% (including 90%)" (MOF, 2006b). Previous studies have documented that the guidance added into principles-based accounting standards may affect accounting professionals' judgments (e.g. Agoglia *et al.*, 2011). Thus, precise guidance and bright-line thresholds provided by the MOF may lead to inconsistent judgments between Chinese accounting professionals and counterparties in countries without precise guidance to IFRS.

6.5 Training and Education

The MOF, during the period between 2005 and 2007, conducted nationwide training of accounting professionals such as accountants in enterprises, CPAs, and staffs in regulatory agencies, to facilitate their understanding of the new set of Chinese GAAP and ensure the effective implementation (Liu, 2010). This nationwide training program was considered as important for the consistent implementation of the new set of Chinese GAAP (World Bank, 2009). If the MOF adopts IFRS, it should strengthen IFRS-related training and educational programs, which are essential to ensure the consistent interpretations and implementation of IFRS in China.

Indeed, the cost of IFRS-related training and education in China is expected to be higher than in Anglo-American countries, whose concepts and principles are mostly reflected in IFRS (Feng, 2001). The understanding of these concepts behind each standard is essential to make appropriate judgments and to properly interpret and apply IFRS in the way intended by the IASB (ICAS, 2010). Actually, financial reporting preparers in Chinese companies and Chinese CPAs have been faced with considerable difficulties in applying the concepts included in IFRS, such as the concepts of fair value and impairment losses (World Bank, 2009).

The education about the reasoning and accounting models behind IFRS, which are different from those of Chinese GAAP, is likely a challenge for China. That is because in most Chinese universities, there is a lack of well-trained and highly knowledgeable teachers to give instruction in the accounting environment and models in Anglo-American countries, and furthermore, the accounting curricula in some Chinese universities focused only on Chinese GAAP and Chinese auditing standards (World Bank, 2009). The university-level education in China has not yet encompassed significant IFRS content to provide enough accounting professionals that are skilled in applying IFRS. Thus, the training burden will largely on the individual Chinese enterprises if the MOF adopts IFRS.

Actually, the MOF has acknowledged the shortage of skilled IFRS users as one of urgent issues concerning IFRS implementation in China. In order to develop human resources to address the challenge of the global convergence of financial reporting, the MOF launched a 10-year plan in 2005, called 'Leading Accounting Talent Project' (*lingjunrencai peiyangguihua*), and trained 1,327 leading accounting talents who can apply both Chinese GAAP and IFRS (MOF, 2016b). Candidates for this project have been selected from both public and private sectors, such as large companies, regulatory agencies, CPAs and accounting academics (MOF, 2007a). The MOF, in 2016, established the next 10-year plan, and intended to increase the number of trainees in this project to over 12,000 until 2020 and over 17,000 until 2025 (MOF, 2016a). In developing high quality training and educational programs, the MOF has been playing a leading role and provided funds. The MOF also has collaborated with three NAIs, the Chinese Institute of Certified Public Accountants (CICPA),[34] and the Accounting Society of China (ASC).[35] Furthermore, in order to implement the next 10-year plan, the MOF have to seek the cooperation of universities, national ministries, large companies, local governments, and accounting firms (MOF, 2016a).

Although the national talent training programs contributes to the increase in skilled IFRS specialists, the number of trainees is limited and can only meet the human resources needs of a small cadre of Chinese enterprises, such as internationally orientated companies (Wang, 2012). The MOF showed its intention "to advance the use of IFRS within China and other related issues, especially for those internationally orientated Chinese companies" (MOF and IFRS Foundation, 2015) in the 2015 Beijing Joint Statement between the MOF and the IFRS Foundation. This intention is consistent with the contemporary professional infrastructure in China. It is can be expected that the decision of the MOF concerning the adoption of IFRS in China would be cautious in order to keep the accounting system compatible with the professional infrastructure.

Chapter 7

Discussion and Conclusion

7.1 Summary and Results

By applying the accounting ecology framework developed by Gernon and Wallace (1995), this study examined the primary features of the Chinese-specific accounting environment and outlined its effects on the convergence of Chinese GAAP with IFRS. Table 7.1 and Figure 7.1 summarize the main Chinese-specific contextual factors that promoted the convergence of Chinese GAAP with IFRS.

Table 7.1: Main Factors Promoting the Convergence of Chinese GAAP with IFRS

	Contextual factors	**Effects on convergence with IFRS**
Societal Environment	rapid growth of FDI and foreign trade since 1978	globalized Chinese companies' business and organizational activities
Organizational Environment	rapid growth of Chinese domestic capital markets and the number of Chinese listed companies	created demands for transparent and relevant financial information
	an increasing number of Chinese companies raised funds in overseas capital markets	forced Chinese companies to apply IFRS to meet the financial information needs of foreign investors
Professional Environment	a small cadre of elites in Chinese accounting professionals have been equipped with sound knowledge and skills to apply IFRS	provided the necessary professional infrastructure to adopt fair value measurement and principles-based accounting standards into Chinese GAAP
Individual Environment	senior officials within the MOF recognized that economic globalization and accounting convergence are irresistible trends	senior officials within the MOF promoted the convergence of Chinese GAAP with IFRS
Accounting Environment	the MOF recognized the necessity of adopting international accounting practices for market-oriented economy development in China	the MOF carried out internationalization-oriented accounting system reforms since 1980s

Source: prepared by the author.

Specifically, since 1978, China experienced rapid growth in FDI and foreign trade, which gradually internationalized the business and organizational activities of Chinese enterprises. This forced the MOF to converge Chinese GAAP with IFRS in order to facilitate business activities of foreign enterprises in China and Chinese enterprises' global activities such as listing in overseas capital markets.

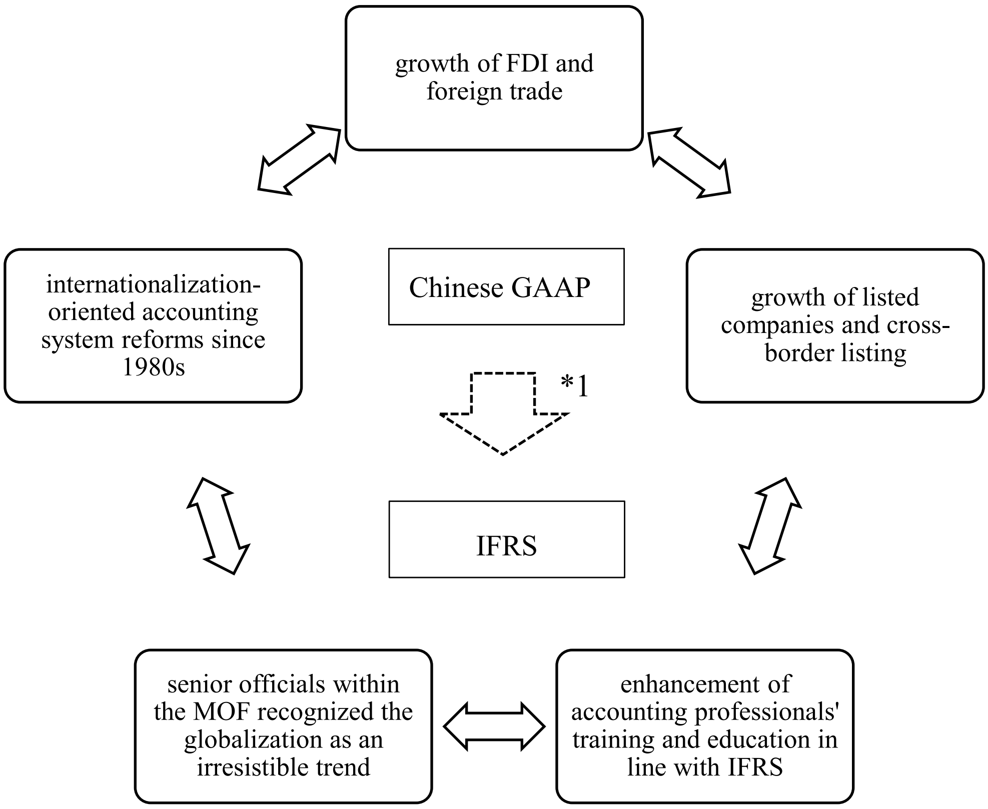

Figure 7.1: Chinese Accounting Ecology Related to the Convergence with IFRS
Source: prepared by the author.
Note: *1 The MOF has been converging Chinese GAAP towards IFRS.

Along with the introduction of market mechanisms into China since 1978, Chinese enterprises diversified their ways of raising funds. An increasing number of Chinese enterprises issued shares and got stocks listed in domestic and foreign capital markets. This forced the MOF to converge Chinese GAAP with IFRS in order to improve the financial reporting quality of Chinese enterprises to facilitate the investment decision-making of investors and creditors in capital markets.

Chinese leaders recognized that Western-style accounting profession and external auditing are necessary institutions for the development of a market economy. Thus, from 1980s onward, Chinese leaders and the MOF devoted efforts to the development of China's accounting professionals. Particularly, three NAIs were established in the early 2000s and have been providing accounting-centered trainings to a cadre of Chinese accounting professionals, by introducing courses that are consistent with international accounting and auditing standards. The trainings equipped a small cadre of elites in Chinese accounting professionals with sound knowledge and skills to apply IFRS. This provided the MOF with necessary professional infrastructure to converge Chinese GAAP with IFRS.

Senior officials within the MOF (e.g. Wang Jun, former Vice Minister of the MOF) recognized that economic globalization and accounting convergence are irresistible trends, and they promoted the convergence with IFRS during 2005 and 2006 by establishing a new set of Chinese GAAP.

Actually, since 1978, reformers within the MOF have made efforts to adopt accounting practices in developed countries in order to meet financial information needs in a developing market economy in China (Ezzamel *et al*., 2007). This led to the progressive convergence of Chinese GAAP with IFRS. Importantly, during the convergence process, the MOF accumulated experience and developed competence to establish Chinese GAAP by using the international accounting standards for reference and modifying these standards to accommodate them to Chinese-specific context. Wang Jun, former Vice Minister of the MOF, remarked that the “over two decades of solid efforts of internationalization-oriented accounting standards reform” (Camfferman and Zeff, 2015, pp.527-528) prepared the ground to achieve the “substantial convergence” of Chinese GAAP with IFRS from 2005 to 2006.

One the other hand, findings of this study suggest that certain features of the Chinese accounting environment may hinder the direct adoption of IFRS in China, as shown in Table 7.2 and Figure 7.2. Specifically, China is in transition from a centrally-planned economy to a market-oriented economy. The Chinese government still exerts a strong influence on the economic resources allocation, such as giving SOEs priority to get bank loans and imposing restrictions on foreign investors’ investment in Chinese domestic capital markets. Due in part to these facts, market mechanisms are relatively limited in China. This may lead to a relatively passive demand for transparent financial information to improve resources allocation in China.

The secondary sector is an important contributor to Chinese economy as it accounts for about half of China's GDP. The relatively high weight of the secondary sector may impede the extensive application of fair value measurement in Chinese accounting system.

In a Confucian cultural environment, Chinese enterprises and regulatory agencies emphasize on the capital accumulation and prevent the excessive distribution of capital in order to achieve permanent development of enterprises. This may lead to prudent and conservative virtues and may limit the fair value measurement application in China.

Table 7.2: Main Factors That Would Hinder the Direct Adoption of IFRS in China

	Contextual factors	**Effects on convergence with IFRS**
Societal Environment	high proportion of secondary sector	restraining the extensive application of fair value measurement
	the emphasis on the capital accumulation and preventing the excessive distribution of capital	leading to prudent and conservative virtues and limiting the application of fair value measurement
Organizational Environment	the limitation on foreign investors' investment in Chinese domestic capital markets	Chinese domestic investors are the major users of financial reports of Chinese enterprises
Professional Environment	the relatively small size of Chinese CPAs	may impair the quality of auditing and challenge the consistent application of IFRS in China
	Chinese accounting professionals are accustomed to a rules-based approach	may be incompetent to consistently interpret IFRS and make appropriate judgments
Individual Environment	senior officials within the MOF contended that accounting standards should consider national contextual factors	senior officials within the MOF oppose the direct adoption of IFRS
	major lobbying groups of accounting standards in China opposed the extensive application of fair value measurement	the MOF has been cautious about the extensive application of fair value measurement
Accounting Environment	Chinese listed companies abused fair value measurement during 1998-2000 to inflate reported profits	

Source: prepared by the author.

Because the Chinese government imposed stringent restrictions on foreign investment in China's domestic capital markets, for most Chinese listed companies, the main users of their financial reports are domestic investors. This may lead to a relatively passive demand for adopting IFRS in China, as IFRS mainly focus on the information needs of investors in the global capital market and are likely to ignore the needs of Chinese domestic investors. For example, Jia Wenqin, the Chief Accountant and the head of the Accounting Department within the CSRC, pointed out that the extensive application of fair value measurement may not be consistent with the information needs of Chinese domestic investors (Jia, 2010).

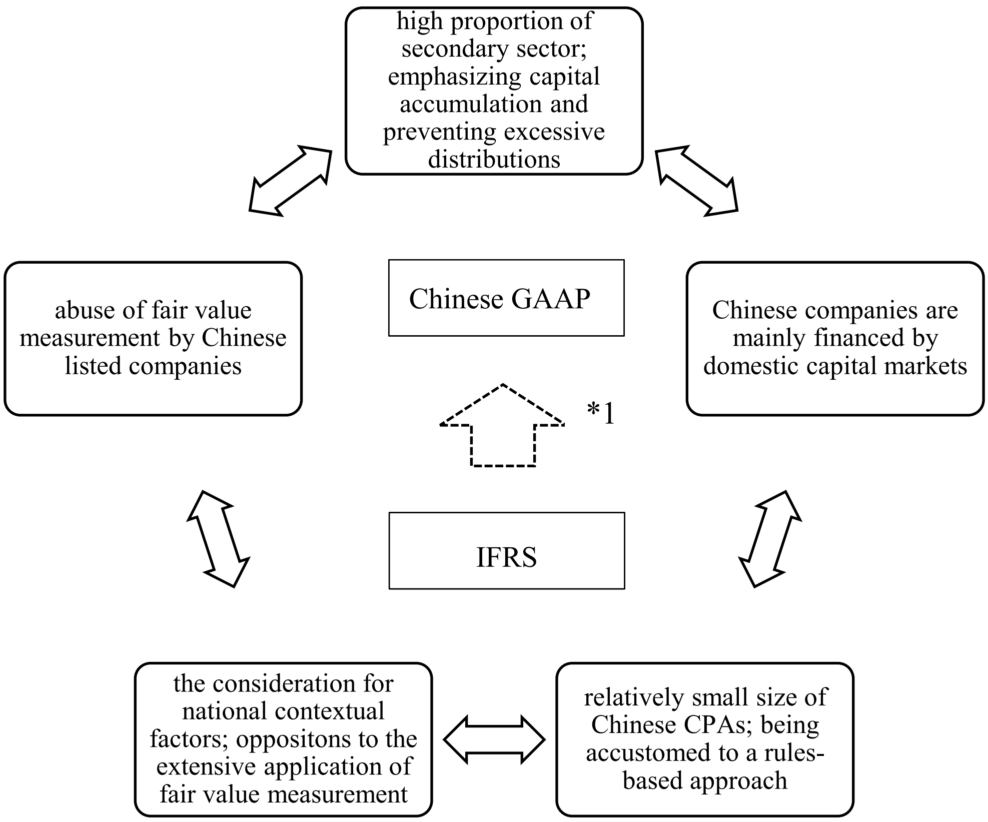

Figure 7.2 Chinese Accounting Ecology Related to the Refusal of IFRS Adoption
Source: prepared by the author.
Note: *1 The MOF rejected the direct adoption of IFRS (either mandatory or voluntary). Furthermore, the MOF has been trying to force the IASB to reflect the features of Chinese-specific accounting environment in IFRS.[36]

The number of Chinese accounting professionals is relatively small compared to that of Anglo-American countries. This may cause a decline in the auditing quality and add difficulty to IFRS implementation in China because high quality auditing is one of the efficient enforcement mechanisms for the rigorous and consistent application of IFRS. Moreover, under the influence of Confucianism, China’s accounting professionals prefer to comply with prescriptive accounting regulations rather than making individual professional judgments. Chinese accounting standards were characterized as rules-based with detailed regulations over a long-period, thus, Chinese accounting professionals have been accustomed to rules-based accounting standards and lack of the necessary education and experience to make appropriate interpretations and judgments under principles-based accounting standards. This factor may lead to practical problems of IFRS in China because principles-based IFRS tend not to provide precise guidance and interpretations.

Although reformers within the MOF promoted the adoption of certain international accounting practices in China, they contended that accounting standards should reflect Chinese-specific context, such as the economic environment, legal system, cultural tradition, enforcement system and professional competence. These Chinese-specific contextual factors may impede the consistent application of IFRS in China. This provided the MOF with a rationale to oppose the direct adoption of IFRS.

Moreover, regulators, such as the CSRC, the CBRC and CIRC, are deeply involved in the process of establishing Chinese GAAP. These regulators recognized that contemporary Chinese context may not be favorable for the direct adoption of IFRS. Furthermore, the implementation of IFRS in China may result into unintended consequences. For instance, the CSRC pointed out that the extensive application of fair value measurement may enlarge the volatility of listed companies' reported profits and exacerbate swings in the capital markets (Jia, 2010). These lobby groups forced the MOF to be cautious about the extensive application of fair value measurement in Chinese GAAP.

Actually, the MOF has been concerned about practical problems caused by the extensive application of fair value measurement. Specifically, Chinese enterprises may have difficulty in obtaining active market prices to measure the fair values of certain assets and liabilities. Additionally, as financial reporting preparers and CPAs lack competence in measuring and disclosing fair values precisely, the reliability of financial statements reported by Chinese enterprises may decline. Thus, the MOF recommends the application of historical cost measurement and permits or requires fair value measurement only to cases where fair values will be reliably measurable on a continuing basis. Actually, by adopting the convergence approach, the MOF incorporated IFRS into Chinese GAAP but revised them to reduce the impact of fair value measurement in many areas (Biondi and Zhang, 2007).

Furthermore, this study clarified other factors that may cause challenges to the direct adoption of IFRS in China, including the endorsement process, the interpretations of IFRS by the MOF and Chinese accounting professionals, the costs of IFRS implementation, the translation of IFRS into Mandarin Chinese and the IFRS-related training and education.

Even if the MOF directly adopts IFRS, the endorsement process may create "IFRS as endorsed by the MOF" with modifications and exclusions of IFRS to accommodate Chinese interests. Additionally, the time lag between the release of a standard by the IASB and its endorsement by the MOF is likely to hinder the comparability of financial reporting between Chinese enterprises and firms in other IFRS-adopting countries.

Findings of this study suggest that Chinese accounting professionals may face problems in consistently interpreting and applying IFRS if the MOF directly adopts IFRS. The MOF is likely to provide interpretations and application guidance to facilitate the IFRS implementation. However, precise guidance by the MOF may affect accounting professionals' independent judgments and lead to different accounting treatments in Chinese enterprises from those in other IFRS-applying enterprises even for the same transactions and economic events. Thus, direct IFRS adoption may not necessarily lead to the improvement in the comparability of financial reporting across countries.

The direct adoption of IFRS is expected to cause high implementation costs for Chinese enterprises. The costs would be led by the need to recruit accountants accomplished at applying IFRS or re-train exiting accountants with IFRS-related knowledge and skills. Additionally, the direct adoption of IFRS would largely increase the enforcement and regulation costs of regulators such as the MOF and the CSRC. The main costs that have been identified by this study are led by establishing interpretations and precise implementation guidance for principles-based accounting standards, updating officials' professional knowledge, and preventing the opportunistic application of accounting standards that give more discretion to managers. Furthermore, as most Chinese domestic accounting firms have no experience in auditing financial statements prepared in accordance with IFRS, they need to devote great financial resources to foster IFRS-specific capabilities, such as training of CPAs and developing procedure manuals.

The proper translation of IFRS into Mandarin Chinese will also be a challenge for the direct adoption of IFRS in China. That is because some concepts corresponding to the ones in IFRS may not exist in existing Chinese GAAP, and the words used to translate the concepts in IFRS may have been already applied in the Chinese context and defined differently from the original meanings in IFRS. Inappropriate translation may lead to improper interpretations and applications of IFRS.

Although the MOF conducted training programs to foster Chinese accounting professionals' competence in applying IFRS, trainees in these programs have been limited to a small cadre of elites. In order to enlarge the supply of qualified accountants and auditors to apply IFRS, the MOF should seek the cooperation of various organizations such as universities, large companies and accounting firms.

7.2 Conclusion

Findings of this study show that contextual factors in China, such as its cultural tradition, capital market development, accounting profession and political system, may lead to inconsistent interpretations and implementations of IFRS. Considering the lack of necessary infrastructures for the consistent IFRS application in China, the direct adoption approach may not be optimal since it may lead to unintended consequences such as a decline in comparability and reliability of financial information prepared by Chinese enterprises. The establishment of surrounding institutions coordinated with IFRS would generate significant implementation and enforcement costs for related stakeholders such as preparers of financial reporting and Chinese regulators.

In the global debate about a more suitable approach to IFRS implementation, specifically, whether it should be the direct adoption or the cautious convergence, this study contributes useful findings to the MOF's policy choices regarding IFRS implementation in China. Although this study used China as a case, it could provide a deeper understanding of accounting practices in other emerging market-oriented economies with similar contextual factors and those countries facing similar challenges caused by convergence with or adoption of IFRS.

Findings of this study also have important applications for the IASB, as it has been promoting direct adoption (either mandatory or voluntary) and consistent implementation of IFRS in nations with diversified accounting environments. Findings of this study suggest that in order to achieve the *de facto* global convergence of financial reporting, the discussions should be extended from simple accounting issues to a more holistic perspective, including societal, organizational, individual and professional environments, and the interactions between these environments with accounting systems.

Following limitation in this study should be acknowledged. This study focused on the convergence of Chinese GAAP with IFRS from 2006 to 2015 and current status of the Chinese accounting environment during the same period, and did not provide a historical analysis of the Chinese accounting system and surrounding institutions. A historical perspective has been acknowledged as important for understanding the formulation of an institution in any specific nation. Aoki (2001) stated that "it is necessary to rely on comparative and historical information to understand why particular institutional arrangements have evolved in one economy but not in others" (Aoki, 2001, p.2). Understanding the formulation process of the accounting system and surrounding institutions in any specific country requires studies to expand the investigation to more than a single stage of change, and more than just the contemporary state of the accounting system and surrounding institutions. This suggests that future researches can examine the historical development of the accounting system and surrounding institutions, which have shaped current practices and circumstances.

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Notes

1. See http://www.ifrs.org/Use-around-the-world/Pages/Analysis-of-the-IFRS-jurisdictional-profiles.aspx.
2. Adoption of IFRS in this study indicates applying IFRS as issued by the IASB without modifications, or applying IFRS as endorsed by regional or national regulators (e.g. the European Commission) with potential deletions or modifications (e.g. the "carve-out" from IAS 39 *Financial Instruments: Recognition and Measurement* by the European Union).
3. Convergence is defined in this study as the process of gradually eliminating differences between existing national accounting standards and IFRS. However, IFRS are not necessarily incorporated to replace national accounting standards directly. Thus, convergence does not necessarily eventually result in the adoption of IFRS.
4. Substantial convergence, as defined by officials within the MOF, means that the principles of recognition, measurement and reporting in Chinese GAAP are the same as those in IFRS, leading to the same accounting numbers in financial statements in accordance with either IFRS or Chinese GAAP (Wang, 2006a; Liu, 2006).
5. The National Bureau of Statistics of China established the standards for classifying enterprises into large, medium, small-sized enterprises and micro-enterprises, and set different criteria for different industries. For example, in mining, manufacturing, electricity, heat, gas and water production and supply industries, enterprises with more than 1,000 employees and more than 400 million RMB annual revenues are classified as large enterprises, the ones with employees between 300 and 1,000 and annual revenues between 20 and 400 million RMB are classified as medium enterprises (National Bureau of Statistics of China, 2011). The MOF adopted these classification standards to decide the large and medium-sized enterprises, which are required to prepare financial statements in accordance with the new set of Chinese GAAP.
6. The Accounting Regulatory Department is the department within the MOF that is responsible for establishing Chinese accounting standards.

7. The MOF defined a business combination under common control as "the combining enterprises are ultimately controlled by the same party or parties before and after the combination, and control is not transitory" (MOF, 2006b).
8. Actually, the officials within the MOF usually float a policy proposal in the form of publishing a journal article. The *Accounting Research* is one of the leading accounting journals in China.
9. The G20 is an international forum for the governments and central bank governors from 20 major economies, including Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, South Korea, Turkey, the United Kingdom, the United States, and the EU. These 20 economies, collectively, account for around 85% of the gross world product, 80% of world trade, and two-thirds of the world population.
10. The Trustees of the IFRS Foundation meet every quarter to discuss and vote on particular projects and the progress of the IFRS Foundation's mission to develop a single set of global standards.
11. Deng Xiaoping defined the "Reform and Opening Up" policy as two interactive facets. Economic reform refers to the introduction of market mechanisms into Chinese economic system. Opening up refers to promoting the inflow of FDI, and introducing advanced foreign technologies and business management experience into Chinese enterprises to develop an export-oriented economy (Wu, 2005). These two parts reinforce each other (Wu, 2005).
12. The term of "the real economy" mainly refers to the manufacturing industry (Jia, 2010, p.9), being concerned with businesses using resources to produce goods and services.
13. Hong Kong Special Administrative Region of the People's Republic of China has independent jurisdiction to regulate its capital market. Thus, in this study, Chinese domestic capital markets exclude the Stock Exchange of Hong Kong, and include only the Shanghai Stock Exchange and the Shenzhen Stock Exchange.
14. For example, between January and June 2015, Chinese enterprises raised 14,183.3 million USD by Initial Public Offerings (IPOs) in the Stock Exchange of Hong Kong, while raised 204.7 million USD by IPOs in other overseas capital markets, including

NASDAQ, the London Stock Exchange, and the Australian Securities Exchange (see www.pedata.cn).

15. Business entities that are not capital market-oriented refer to those that have not offered shares to the public or listed shares in capital markets.

16. The four largest commercial banks are the Industrial and Commercial Bank of China, the Bank of China, the Construction Bank of China and the Agricultural Bank of China, in which the Chinese government, as December 31, 2015, held 69.31%, 64.02%, 57.31% and 82.3% of the outstanding shares, respectively.

17. The ratio was calculated based on statistics of "Sources and Uses of Credit Funds of Financial Institutions" provided by the People's Bank of China.

18. Accounting professionals in China first emerged in 1918. By 1947, there were 2,619 certified accountants in China (Doupnik and Perera, 2012, pp.237-238). In 1949, the Chinese CPA system was repealed.

19. The Chinese Institute of Certified Public Accountants (CICPA) announced that there were 217,742 CPAs as of May 5, 2016. The FSA (2010) shows that there were 342,490 CPAs in the United States.

20. To improve the auditing quality of listed companies, the MOF and the CSRC introduced a qualification system and required that accounting firms providing auditing services to listed companies should acquire licenses jointly issued by these two regulators. Only CPAs in accounting firms with licenses are eligible to audit Chinese listed companies.

21. The number of 24,146 CPAs as of December 31, 2014 who were eligible to audit Chinese listed companies was calculated by the author by adding up numbers of CPAs in 40 accounting firms that have licenses to audit listed companies. The numbers of CPAs in each accounting firm are shown in Table 5.7.

22. The term of "the 'fictitious' economy" mainly refers to the financial sector (Jia, 2010, p.9), being concerned with businesses of buying and selling securities in the financial markets.

23. The modified historical cost accounting includes accounting treatments such as measuring short-term investments at lower of cost or market, measuring inventory at lower of cost or realizable value and impairment accounting for fixed assets.

24. The only exception was for fund assets held by mutual fund companies. According to the *Accounting System for Financial Institutions* issued in 2001 by the MOF, fund assets traded in capital markets should be measured at their fair values.
25. When a biological asset for which quoted market price is not available and for which alternative fair value measurement is determined to be clearly unreliable, IAS 41 requires enterprises to measure the biological asset on initial recognition at its cost less any accumulated depreciation and any accumulated impairment losses (IASB, 2016g, para. 30).
26. Level 3 inputs are unobservable inputs used to estimate the fair values of assets and liabilities (IASB, 2016h, para. 86).
27. The National People's Congress of China is the national legislature of China, with the power to legislate laws, to oversee the operation of the government and to elect the major officers of the state.
28. For example, the EU had conducted an endorsement mechanism for existing IFRS and future amendments and new establishment of IFRS. This mechanism grants the EU a veto right on IFRS implementation in this region, and ensure its influence in standards-setting process of the IASB. This had been highlighted by changes of IFRS in response to the pressure from EU during the global financial crisis, such as allowing reclassification of financial assets out of the "fair value through profit or loss" and "available-for-sale" categories (Camfferman and Zeff, 2015).
29. According to Chand *et al*. (2010), accounting professionals' familiarity with accounting standards in IFRS may be due to the history of accounting standards establishment in a nation as well as accounting professionals' training and experience to apply such accounting standards.
30. Actually, 1,549 Chinese listed companies conducted profit distribution in 2011. Among them, 1,471 companies decided distribution amounts based on the non-consolidated financial statements while 78 companies decided distribution amounts based on the consolidated financial statements (MOF, 2011a).
31. The MOF is responsible for supervising the financial reporting and auditing of all Chinese enterprises. The CSRC mainly supervise the financial reporting and auditing of

Chinese listed companies and certain un-listed companies under its supervision, such as un-listed securities companies.

32. The CASC is an organization under the supervision of the MOF. The head of the CASC is occupied by the General Direct of the Accounting Regulatory Department within the MOF. The CASC is responsible for drafting the Chinese GAAP, tracking and participating in the researches of international accounting standards, and participating in the accounting-related foreign exchanges and cooperation. Specifically, according to the introduction of the CASC up to the date of October 9, 2016, current responsibilities of the CASC are as follows.

    (1) According to the actual situations of China's economic development, the CASC conducts researches on domestic and foreign accounting standards, and serves the establishment of Chinese GAAP and a single set of high quality global accounting standards;

    (2) the CASC tracks and conducts researches on international accounting standards, analyzes the trends of IFRS revisions and establishment, writes research reports and offers suggestions to the MOF;

    (3) the CASC keeps contacts with the IASB and promotes the accounting-related foreign exchanges and cooperations.

33. In January, 2016, the IASB issued IFRS 16 *Leases* to replace IAS 17 *Leases*. IFRS 16 *Leases* also adopted probability expressions of "major part" and "substantially all" to prescribe the criteria for the classification of a lease as operating or capital lease (IASB, 2010; IASB, 2016i, para. 63).

34. The CICPA is a self-regulatory organization of Chinese CPAs. The CICPA is under the guidance of the MOF and the State Council.

35. The ASC is a self-regulatory organization of Chinese accounting academics, and is under the guidance of the MOF.

36. Since 2005, the MOF has endeavored to send Chinese representatives to organizations related with the IFRS establishing, including the IFRS Foundation, the IASB, the IFRS Interpretations Committee and the IFRS Advisory Council. By 2010, with the appointment of Li Feilong, the Vice President and Chief Financial Officer of China

Oilfield Services Company, as a member of the IFRS Interpretations Committee, there were Chinese representations in all above-mentioned organizations. The MOF expects to timely present the features of Chinese-specific environment to the IASB and force the IASB to reflect Chinese-specific accounting issues in IFRS through these representatives (MOF, 2010a). Actually, the IASB, according to China's suggestions, had revised IAS 24 *Related Party Disclosure* to eliminate disclosures for state-controlled business entities about transactions with other state-controlled business entities when control, common control and significant influence between/among these business entities do not exist (IASB, 2008). Moreover, the MOF declared that the IASB agreed to co-opt Chinese experience and approach for accounting standards related with business combinations under common control and the fair value measurement in countries with emerging market economy (MOF, 2010a).