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# **Accounting system in China:**

An Overview on the convergence to IAS/IFRS

### **Supervisor**

Ch. Prof. Michela Cordazzo

### **Assistant supervisor**

Ch. Prof. Franco Gatti

### **Graduand**

Andrea Fiorani

Matriculation Number 859892

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# 前言

本文主要研究中国会计制度的历史沿革。

中国作为每一个发展中的经济体都认为有必要将自己的会计制度国际化,以促进外国市场的进入和吸引外国投资者。

中国政府从 1980 年开始进行了几项改革,以扩大自身的经济,并将中国的会计语言统一到发达国家。由于对中国会计和国际会计的研究引越来越多的外资这与邓小平执政之前所发生的情况形成了鲜明对比。

研究者将中国会计系统的历史 (Gray.1969);(Hofstede and Bond, 1988);(Bromwich and Wang ,1991);(Van Der Laam and Smith, 2010) 划分为六个阶段:

中国传统会计制度的时代,现代与西方的复式记账法的运用、苏联的模式采用、毛泽东思想的阶段、邓小平的大门户开放政策以及中国会计制度的国际化,与国际会计准则 (IFRS) 所认可的中国会计制度具有很大的趋同性。1949 年,中华人民共和国成立后,国民党以前的会计制度被中国政府彻底废除了。首先,所有的外国企业和那些由民族主义党拥有的被改为了国有企业。

关于会计,有一个政治辩论,这些西方的做法是否适合共产主义意识形态 (Ezzamel et al. 2007)。普遍拒绝会计盛行,这被视为资本主义的象征,因此与党的信仰形成了鲜明的对比。因此,在 1953 年,苏联模式被采纳。已颁布新的标准,涉及不同的工业部门 (制造业、农业、银行、贸易和运输)。这些标准为政府提供了经济控制和规划所需的信息。

这些原则是建立在一个新的会计制度的基础上的,也是从苏维埃联盟中引进的,称为基金会计制度。会计的主要目的是帮助政府增加其控制权和权力,因为所有的企业都是国有的。

从 1957 年到 1978 这个阶段为中国积极和会计制度带来了一碟变化。该项目的推出 "大跃进", 旨在加快工业发展, 没有导致预期的结果, 部分原因是自然灾害影响农业和工业生产, 也是由于错误的政治选择。这一失败暂时削弱了毛泽东在共产党中的政治影响力, 从 1962 年到 1965, 邓小平引入了一些变革这个短暂时期被称为 "恢复阶段"。

从会计角度出发, 提出了一种新的双分录记账法, 称为增减法, 即根据基金会计制度, 取代借方/贷记法, 方便了会计数据的收集

(Liu and Eddie, 1997)。

从 1966 年到 1978, 被称为 "文化大革命" 的第二阶段, 显示了毛泽东在共产党的领导下的回归, 并被会计研究者称为 "反科学" 时期 (Carroll and Lu, 1997); (Van Hoepen, 1997); (Graham and Li, 1997)。

这通称是由于在这一时期发生了巨大的会计落后。

会计研究被禁止从大学和会计实践被认为是太复杂的由一般人管理, 和被考虑反对社会主义的原则。

私人利润不如国家利润重要。毛泽东于 1977 年逝世, 是中国社会主义经济的终结。邓小平再次崛起, 以新的市场经济观为导向, 取代了以往的计划经济体制。最具国际共鸣的改革是 "门户开放政策", 这意味着外国资本在中国的入口。他还创建了四个经济特区, 为外国投资者提供财政优惠待遇、奖励和有利的立法。这些年来, 大量的西方会计学者来到中国, 许多中国留学生去国外发展会计技能。一个事实出现了: 中国的会计制度不完善, 仍以资金为基础, 不能再面对经济的快速发展。

(Bromwich and Wang, 1991).

中国的第一部会计法是 1979 年颁布的“中外合资投资”，财政部于 1985 年颁布了中外合资经营企业会计准则。这是现代会计系统顺应国际方法的第一个信号。

迈向国际协调的第一个具体步骤是用旧货币方法取代西方的基本会计方程式： $资产 = 负债 + 股本$ 。在报告方法方面，中国法律要求合资企业编制三份文件，并将其送交地方政府的行政和财政部门：资产负债表、损益表和现金流量表。这个新的章程的最重要的变动，仅强制为合资企业，除替换之外基金会计制度是：

- 引入资产概念，这意味着承认公司是国家的独立实体。
- 对其使用费用的分类，因此直接费用、一般开支和人工费用。
- 介绍用于记录汇兑损益、无形投资和组织成本的方法。

这项关于合资企业的条例于 1991 年续签，并扩大到所有有外国投资的企业。考虑到中国企业，第一条规则是 1985 年颁布的《中华人民共和国会计法》。它由 6 章和 31 篇文章组成，并成为所有国有企业，政府机构和军队的强制性。除这一综合性法律外，还有国务院颁布的其他两条条例：国有企业成本管理条例和国有企业固定资产折旧暂行规定。

在这一时期，公司会计实务遵循了财政部规定的具体部门。

有 40 不同的规则与每个产业有关。

随着中国经济发展的进一步变化，1987 年为大中型国有企业引入了“契约责任制”。在向政府纳税后，这些公司的经理和工人可以分配并划分最终的盈余资本。新颁布的标准在 1992 年，被称为旧中国会计准则，或 ASBEs，适用于所有公司，无论其具体部门。

这标志着从基于资金的会计制度到西方基于资产和收入的会计概念的最终通过。这一新的章程由 10 个章节和 66 篇文章组成，其中四条更清楚地代表开放对外国市场和投资者的意图：-会计实体-持续关注-会计期间或周期-货币计量本章涉及一般事项，如一般原则、资产、损失、净

利润、费用、收入、资产负债表和其他要求。除了 ASBE, 上市公司必须遵守新的公司法, 在 1994 年生效。这规定了另外两份文件的编校, 例如关于公司财务状况的解释性说明和利润分享计划。

还为企业发行了一般财务原则。

它的目标是规范《中国公认会计准则》中规定的原则, 让所有公司都使用它们。发行 **OLD PRC GAAP** 的主要贡献是, 引入了一个共同的概念框架, 尽管定义不太明确, 但它将成为所有公司的 "指南", 而不考虑该部门。虽然 ASBEs 的内容是部分借用了 IASB (当时还是 IASC), 但可能会遇到一些重大差异。ASBEs 框架与 IASB 之间的根本区别的一个要素是 ASBEs 中没有直接或间接提及的 "形式之上物质" 的假设。这种差异, 由于会计准则的基于规则的性质是显而易见的, 如果人们再次认为, 信息的主要使用者是国家, 其目的是控制。

可以推断出的主要动机不仅是基于规则的模型, 而且还归因于在中国应用的税收导向模型。中国财政部认识到存在着剩余的差异, 并为了继续其经济的国际化, 继续改革企业会计准则, 并于 1998 年和 2001 进行修订, 最后在 2006 年进行。为消除《中国会计准则》与《国际财务报告通则原则》之间仍存在的差异, 中国财政部在 1998 年提出了一项新的改革 (上市公司会计新规), 通过该制度, 中国上市公司的会计实务将与国际会计准则的要求相协调, 同时也减少了上述研究所确定的利润差距。然而, 这仍然是一个早期阶段, 这是通过对当时的中国公司的预算进行的研究表明, 这仍然显示出巨大的差异, 中国企业的收

入的确定适用中国原则 (发行 A 股) 和那些应用国际原则 (也发行或仅发行 B 股)。实证研究表明, 1998 的改革在财务报表与 IFRS 原则的可比性方面具有边际效用。当然, 最具创新性的概念是引入公允价值用于资产和负债的估值。由于世界银行于 2001 年在 1999 年 (会计改革和发展项目) 拨款, 中国财政部再次对企业会计制度进行了新的改革, 从 2001 年 1 月 01 日起生效。

这是第三个步骤, 目的是将中国的原则与国际准则统一起来。

1998 改革和 2001 年的一个主要区别在于评估存货、应收账款、投资和有形固定资产。这些年进行的研究 (Peng et al. 2008); (Foo et al. 2009); (Kuan and Noronha, 2007) ;(Chen and Zhang, 2010) 与 1998 改革相比, 中国会计准则与国际财务报告准则的可比性显著提高。一个重要变动是对公平的价值用途的禁止。

在这种背景下, 对公允价值的使用的禁止应在中国不完善、不成熟的市场上加以解释。此外, 在 1998 年的第一次介绍中, 对会计信息的需求还没有得到很好的发展。2006 的改革是我国会计协调过程中的最后一步。这第四步是正式的在 2006 年 2 月以介绍 22 新的标准 (cas) 和修改 16 现有与生效在 01/01/2007。为了更加重视改革, 中科院 (中国会计准则委员会) 和 iasb 在 2005 年 11 月签署了一份备忘录, 确认与《国际财务报告准则》的原则有很大的一致性, 除了与中国具体情况有关的一些方面。

在 2005 年与国际会计准则理事会签订的备忘录之后, 欧洲委员会于 2007 年通过了 1569 条, 界定了一个非欧洲国家的会计准则在三年过渡期内可被视为等同的条件。在 2008 年 3 月, **CESR**(欧洲证券监管委员会) 表示, 中国、加拿大、印度和韩国都是这种过渡性对等的受益者, 考虑到它们的原则相当于国际财务报告准则, 直到 2011 年 12 月 31 日。最重要的研究关于 **ASBEs 2007** 及其影响的主要研究 (**Ding and Su, 2008**); (**Heng, and Noronha, 2010**); (**Peng and Bewley, 2010**); (**Peng et al. 2010**); (**Zhang et al., 2010**); (**Liu et al. 2011**); (**Olesen and Chen, 2011**); (**He et al. 2012**); (**Wang et al. 2012**); (**Qu. et al. 2012**); (**Zhu and Sun, 2012**); (**Hou et al., 2014**) 同意他们带来积极的影响, 不仅让有质量的财务报告, 而且更加地透明度和正确性的信息在中国会计系统。

2001 年废除的公允价值计量的重新引入, 无疑代表了中国真正的 "跃进"。随着 **ASBEs 2007** 的引入, 中国会计协调的演进阶段尚未完成, 由于财政部一直保持其原则与 **IASB** 建议的标准更新相一致, 正如 2010 年在《**ASBEs 与 IFRS**》的 "持续趋同路线图" 中所确定的那样。

欧盟关于中国会计准则与国际财务报告标准等价性的报告, 在 2010 年 12 月 31 日的声明中, 中国政府已取消了与 **PRC GAAP (CAS)** 和 **IFRS** 之间的主要区别, 除了资产减值的逆转, 中国政府认为这是公司操纵经济结果的杠杆。其他小的差异被认为是不相关的目的与 **IFRS** 的等同性, 是有关中国特色的经济, 政治和文化背景。



## INTRODUCTION

This study is focused on the historical evolution of Chinese Accounting System.

China, as every developing economy, has perceived the need to internationalise its own Accounting System to facilitate the entrance on foreign market and to attract foreign investors. Chinese Government, from the open-door policy on, has undertaken several reforms in order to expand its own economy and to uniform the Chinese Accounting language to the developed countries. Meanwhile, the study of Chinese Accounting and the International Accounting researches that focus on China, were constantly increasing and attracting more and more foreign researches, in contrast of what happened before Deng Xiaoping rose to the power. The studies concerned this matter (Gray,1969); (Hofstede and Bond, 1988); (Bromwich and Wang, 1991);(Van Der Laam and Smith, 2010) agree upon the division of the History of Chinese Accounting System in six phases: Accounting System in the Traditional China's period, the modern age and the use of western's double entry bookkeeping, the adoption of Soviet's model, the Maoism phase, the great open-door policy of Deng Xiaoping and the internationalization of Chinese Accounting System with the following substantial convergence of Chinese Accounting standards with IFRS, recognized by IAS. Therefore, the starting point will be the traditional Chinese period and the first use of rudimental Accounting practices in the empire ages. In the following phase, the period of the last dynasty will be analysed, that implied the end of the millennial empire, the birth of the Republic and the will to use Western Accounting system, that did not lead to expected outcomes, due to the rose to the power of Mao Zedong. In 1949, once the People's Republic of China was established, the previous Accounting System used by Kuomintang was completely abolished by Mao Zedong. Firstly, all the foreign enterprises and those owned by Nationalist party were switched in state owned enterprises. Regarding Accounting, there was a politic debate on whether these Western practices were suitable or not for the communist ideology (Ezzamel et al. 2007). The total rejection of Accounting prevailed, because it was seen as a symbol of Capitalism and, for this reason, in contrast with the beliefs of the party. Consequently, in 1953 the soviet's model was adopted. New standards (UAS) were issued, related to different industrial sectors (manufacturing, agricultural, banking, trade and means of transport). Those standards provided to the government the information needed to carry on its economic control and planning.

Those principles were based on a new Accounting System also imported from Soviet's Union, known as Fund Accounting System. The main purpose of Accounting was to help the Government to increase its control and power, since all enterprises were state owned.

The period from 1957 to 1978 is known as Maoism phase, because Mao himself brought several changes that shaped Chinese economy and Accounting System.

The launch of the program "The great leap forward", with the aim of accelerate the industrial development, did not lead to the foreseen results, in part due to natural disaster that affected agricultural and industrial production, but also due to wrong political choices.

This failure temporary reduced the political influence of Mao Zedong in the communist party, from 1962 to 1965 and allowed Deng Xiaoping to introduce some changes.

This short period is called "the recovering phase".

From an Accounting point of view, he has introduced a new method of double entry bookkeeping, called increase/decrease method that, according with Fund Accounting System, has replaced the debit/credit method and facilitated the Accounting collection of data (Liu and Eddie,1997). The following phase, from 1966 to 1978, known as "Cultural Revolution", showed the return of Mao Zedong on the head of the communist party and has named by Accounting researchers as "anti-scientific" period (Carroll and Lu, 1997); (Van Hoepen, 1997); (Graham and Li, 1997). This appellative is due to a huge Accounting regression that occurred in this period. Accounting studies were banned from universities and Accounting practices were considered too complicated to be managed by ordinary people, and were considered against Socialist principles. The private and entrepreneurial profits were less important than the profit of the State. The death of Mao Zedong in 1977 can be seen as the end of the Chinese socialist economy. Deng Xiaoping rose again to the power and a new concept of market economy Western oriented replaced the previous planned economic system. The reform that had the most international resonance was the "open door policy", that meant the entrance of foreign capital in China.

He has also created four special economic zones to attract foreign companies, providing fiscal preferential treatments, incentives and advantageous legislation for foreign investors. In these years, plenty of Western Accounting scholars came to China and a lot of Chinese students went abroad to develop Accounting skills and to learn methodologies that they will put in practice some years later. A fact that came to light is the inadequate and obsolete Accounting System of China, still based on Funds, could not face any more the rapid development of economy. (Bromwich and Wang, 1991).

The first Accounting law issued by the Chinese Government was the “Joint venture using Chinese and foreign investments” in 1979, on which the Ministry of Finance promulgated in 1985 the Accounting regulation for joint ventures using Chinese and foreign investments. This was the first signal of the modern Accounting system towards a compliance with international methodologies. A significant step towards international harmonisation was the substitution of the old method based on Funds with the Western Accounting basic equation:  $\text{assets} = \text{liabilities} + \text{equity}$ .

As far as reporting methodologies are concerned, the Chinese law required Joint ventures to prepare three documents and send them to the administrative and fiscal offices of the local government: balance sheet, income statement and cash flow statement.

The most important changes of this new regulation, mandatory only for joint ventures, besides the substitution of Fund Accounting system were the introduction of the concept of assets, that implied the recognition of the companies as independent entities from the state. Moreover, the classification of the costs in regard of their use, therefore direct expenses, general expenses and labour costs. Finally, the introduction of methodologies to record gain and losses on exchange, intangible investments and organisational costs.

This regulation regarding joint ventures was renewed in 1991 and it was extended to all enterprises with foreign investment. Considering the Chinese companies, the first regulation was the Accounting Law of the People’s Republic of China, issued in 1985.

It was composed of 6 chapters and 31 articles and became mandatory for all state-owned enterprises, Government agencies and army.

In addition to this comprehensive law, there were two other regulations issued by the State’s Council: the Regulation on cost management of state-owned enterprise and the Tentative Regulation on Fixed Assets Depreciation for state-owned enterprises.

In this period, the Accounting practices of companies followed the rules of Ministry of Finance according to their specific sector. There were 40 different regulations related to each industry. An additional change with the aim of increasing Chinese economic development was the introduction of the “contract responsibility system” for medium and big state-owned enterprises in 1987. Managers and workers of these companies could distribute and divide an eventual surplus capital among them, after having paid taxes to the government. This was an important achievement in terms of manager’s autonomy and a significant step towards the constitution of a shareholder’s system, that was completely accomplished, in terms of Accounting practises, in 1992 with the issuance of Accounting system for experimental enterprises with shareholding system and later with the issuance

of Accounting standards for business enterprises and financial guidelines for business enterprises. The Government ceased to be the unique user of financial statements, since in 1990 the Shanghai and Shenzhen stock exchange were established and new shareholders began to come in. The new issued standards in 1992, known as OLD PRC GAAP, or ASBE, were applicable for all companies regardless of their specific sector. This event marked the definitive passage from an Accounting system based on funds to a western concept of Accounting based on assets and revenues.

The new regulation was formed by 10 chapters and 66 articles, in which four of them represented more clearly the intention of opening to foreign market and investors.

These were the Accounting entity, the going concern concept, the Accounting Period or periodicity and the monetary measurement.

The chapters dealt with general matters, such as general principles, assets, losses, net profit, costs, revenues, balance sheet and other requirements.

One of the most important principles regarded historical cost and introduced for the first time in Chinese Accounting System, was the Accounting Conservatism.

It means “to anticipate no profit, but to provide for all losses”, that can be explained with the concept of prudence. The 18<sup>th</sup> article said, “Accounting should calculate possible losses and expenses rationally according to the requirement of conservatism”.

This became rapidly an object of many studies in China, since in the Maoism phase the practice of conservatism was pointed out as a mean of capitalism expansion (Hofstede and Harris Bond, 1988); (Chow et al. 1995); (Van Hoepen, 1995; (Graham and Li, 1997); (Gao and Handley-Schachler, 2003); (Basu, 2009); (Borker, 2012).

In addition to ASBE, the listed companies had to follow the new company law, that became effective in 1994. This law implied the redaction of two more documents, such as an explication note about financial status of the company and a profit sharing scheme. There was also the issuance of General Financial Principles for Enterprises, that had more operating purposes than ASBE. Its goal was to standardize the principles stated in PRC GAAP and to let them be used by all companies.

The aim of Accounting standards was the introduction of a new Chinese conceptual framework, while the one of Financial Regulations was to introduce operating rules for the company’s management. Despite of good intentions, this objective has not been achieved, mainly because of the difficulty of gathering under a single unit a previously very fragmented Accounting system. However, these were the first steps towards a globalization of Chinese economy.

The major contribution of the issuance of OLD PRC GAAP was to introduce, albeit in a poorly defined way, a common conceptual framework, which would serve as a "guide" for all companies, regardless of the sector. The conceptual framework introduced with the ASBEs was defined in the literature (Xiao and Pan, 1997) as a "mix" of a descriptive, prescriptive and constitutive nature, as it provided general statements (constitutive), drew on existing practices in both China and Western countries (descriptive) and was the result of decisions taken by the Government and developed with special laws (prescriptive).

Although the content of the ASBEs was partially borrowed from the one elaborated by the IASB (at the time still IASC) it is possible to encounter some significant differences. The principal is surely attributable to the information functions to which Accounting standards are proposed. There is only one list, which is hierarchical, of the subjects to which the standards are directed, the first of them is obviously the state.

In this case, the main users of the Accounting information are neither the creditors nor the investors but the state and the financial system (as a creditor) and, lastly, the management of the company. An element of fundamental distinction between the ASBEs framework versus the one of the IASB, is the postulate of the "substance above the form" which in the ASBEs was not mentioned either directly or indirectly.

This difference, related to the rule-based nature of accounting standards is obvious if one thinks once again that the main user of the information is the state and its purpose is control. Another important difference is attributable to the valuation method.

The ASBEs follow the criterion of the historical cost and not the market one.

This aspect is also attributable to the absence of a free market with the consequent impossibility of having a "real" value of the asset being evaluated.

The biggest difference, also highlighted in several researches concerned this matter (Lin and Chen, 1999); (Ball, et al. 2000); (Sun et al. 2005); (Sun et al. 2005); (Liu and Zhou, 2007); (Wei and Tao, 2007), is the lack of orientation towards the "conservative (or prudence) Accounting". This distinction has also been empirically found by the research conducted on the companies issuing both A-shares and B-shares, that have shown an over statement of income and assets by applying Chinese GAAP, rather than applying IFRS (Chen et al., 1999); (Lin et A. 2001); (Chen et al. 2002).

The main motivations that can be deduced are attributable not only to the rules-based model, but also to the tax-oriented model applied in China.

The Ministry of Finance (MOF) is also the standard setting body, it is therefore natural that the concept of prudence and conservatism goes to impact on the tax assessment of companies, resulting in a reduction of revenue for the state.

The Chinese Ministry of Finance, aware of the existence of remaining differences and with the view to continue the internationalization of its economy, has continued to reform Accounting standards for business enterprises, proceeding to revisions in 1998 and 2001 and finally in 2006. To eliminate the discrepancies still existing between the PRC GAAP and the IFRS principles, the Chinese Ministry of Finance proposed in 1998 a new reform (new accounting regulation for listed companies) through which Chinese Accounting practices of listed companies would be harmonized with the requirements of international Accounting standards, also decreasing the gap on profits, identified by the abovementioned researches. However, it was still an early stage and this is demonstrated by the researches that has been conducted on the budgets of Chinese companies at that time which still show large discrepancies in terms of the determination of incomes of Chinese companies applying the Chinese principles (issue of A-shares) and those applying the international principles (issue also or only B-shares).

Empirical researches have shown a marginal utility of the 1998 reform in terms of comparability of financial statements with IFRS principles.

Undoubtedly, the most innovative concept was the introduction of the use of fair value for the valuation of assets and liabilities. Thanks to the funds allocated by the World Bank in 1999 (Accounting Reform and Development Project), in 2001, the Chinese ministry of finance intervened again on Accounting system for business enterprises with a new reform, effective from 01 January 2001. This represented the third step aimed to harmonize the Chinese principles with international ones.

The main differences from the 1998 reform were related to the assessment of inventories, Accounting receivables, investments and tangible fixed assets.

The research conducted in those years (Peng et al., 2008); (Foo et al. 2009); (Kuan and Noronha, 2007); (Chen and Zhang, 2010) have shown an effective increase in comparability between the Chinese GAAP and IFRS International Accounting standards compared to the 1998 reform. Despite this positive feedback, the Chinese Ministry of Finance has made a step forward in the process of harmonization, but also a step backwards with the prohibition of the use of fair value, that was introduced in the previous reform.

In this context, the prohibition of fair value use shall be read in the consideration of Chinese imperfect and immature market (Xiao et al. 2004).

The value to which an asset may be exchanged, or a liability may be settled, in a transaction between independent third parties was not easily assessable.

Moreover, the demand for Accounting information was not yet very developed at the time of the first introduction. As a result of the 2001 reform, the companies issuing A-shares, that are intended to be purchased only by Chinese investors, continued to apply local GAAP, while companies issuing (also or only) B-shares, that are also available to be purchased by foreign investors, had to draw up their own financial statements also according to IFRS International accounting standards.

The 2006 reform represented the last step in the process of Accounting harmonisation routed by China. This fourth step was made formal in February 2006 with the introduction of 22 new standards (CAS) and the revision of the 16 existing with came into force in 01/01/2007. To give greater international emphasis to the reform, the CASC (China Accounting Standards Committee) and the IASB signed in November 2005 a memorandum confirming the substantial convergence with the IFRS principles except for some points, related to specific Chinese circumstances.

Following the memorandum with the IASB in 2005, the European Commission in 2007 with regulation 1569, defined the conditions under which the Accounting standards of a non-EU country could be considered equivalent for a transitional period of three years.

In March 2008, the CESR (Committee of the European securities Regulators) indicated that China, Canada, India and South Korea were beneficiaries of this transitory equivalence, considering their principles equivalent to IFRS until 31 December 2011.

The main studies that affected the ASBEs 2007 and their effects in general terms (Ding and Su, 2008); (Heng and Noronha, 2010); (Peng and Bewley, 2010); (Peng and Van der Laan Smith, 2010); (Zhang, et al. 2010); (Liu et al. 2011); (Olesen and Chen, 2011); (He et al. 2012); (Wang et al. 2012); (Qu et al. 2012); (Zhu and Sun, 2012); (Hou et al. 2014) agree on the positive effect brought by them, in terms of the higher quality of the financial reporting, the transparency and correctness of the information introduced in the Chinese Accounting system. Peng and Van der Laan Smith have analysed the convergence level of Chinese GAAP by analysing 159 items related to the four steps of the harmonisation (1992-2006). The study showed a substantial increase, in terms of convergence to IFRS, from 1992 to 2006 from 20% to 77%. The evolutionary stages of Accounting harmonisation in China have not been finished with the introduction of NEW PRC GAAP,

since the MOF has maintained a constant degree of alignment of its principles with respect to the standards update proposed by the IASB, as established in 2010 in the "Roadmap for continuing convergence of ASBEs with IFRS".

The EU-supplementary progress report on the equivalence of Chinese Accounting standards with International Financial Reporting Standards, on 31 December 2010, stated that the main differences between the PRC GAAP (CAS) and the IFRS have been eliminated by the Chinese government, except for those that are related to Chinese specific economic, politic and cultural background, that are unlikely to be overcome in the near future.



## **Chap1. CHINESE ACCOUNTING SYSTEM: an historical review from the traditional China to the constitution of the People's Republic.**

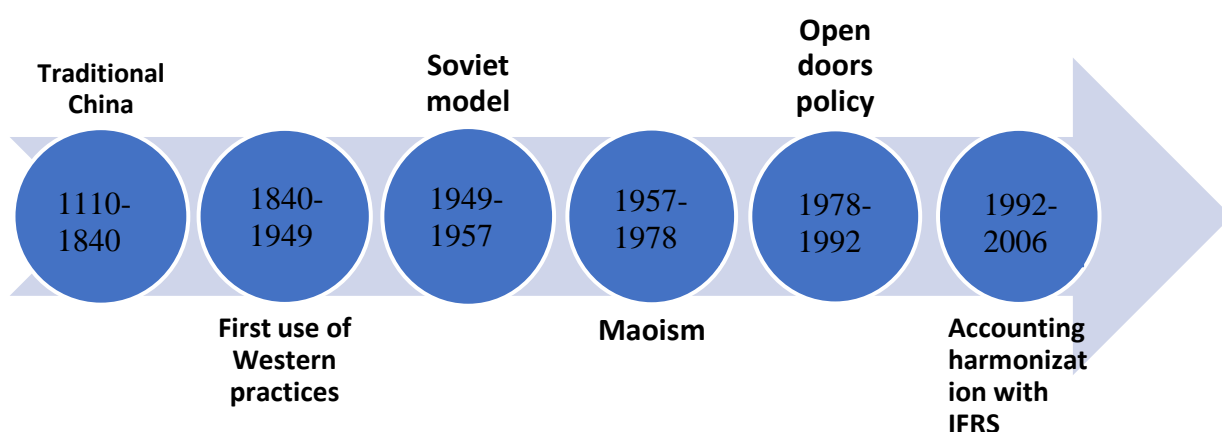
The study of the historical profile with which the Accounting system has developed in China is an opportunity to analyse, in addition to the economic aspects of the companies, the specific characters related to economic development, politics, culture and religion of this millenary civilization. These factors, as we will see in the continuation of this research, have played a crucial role with strong consequences in the way of keeping the accounts. China has been considered for a long historical period as a sort of "unknown planet" in the galaxy of studies in international Accounting.

The reasons are to be found in the social dynamics and policies that have affected the development of China, as well as problems linked to the poor use of the English language, which can still be seen today. Based on the studies that have dealt with the historical evolutions of Chinese Accounting system, we can divide this path into six phases, which are also related to substantial political and economic developments in China.

Let's start describing the Accounting System in ancient China (called Traditional China) (1100 ac-1840), the second step is the modern era and the first uses of Western Accounting Practice in China (1840-1949), after this was the Soviet model in the constitutive phase of the centralized Economy (1949-1957), The Maoism stage (1957 – 1978), the economic reform under Deng Xiaoping (1978 – 1992) and, at last, the creation of Chinese standard (PRC GAAP) and the Accounting Harmonization of PRC GAAP with IFRS (1992 – 2006). The following chart (Graph N°1) shows these phases in a sequential order.

# The phases of historical evolution of the Chinese Accounting system

Graph N°1



Source: elaborated by the author.

## 1.1 Accounting in the traditional China

The Accounting system in China is rooted in the history of the monarchies.

Its first application took place at the time of the Western Zhou Dynasty (1100 – 771 BC)<sup>1</sup>.

Before examining the methods used in the so-called period of traditional China, the first thing to be noted is that the Accounting system in its first applications was used for the administration of the State and therefore had no use in the "private" sector.

The Zhou Dynasty, as well as the former Shang Dynasty, created a feudal state based on a hierarchical patriarchal system and where the people were subjected to a regime of semi-slavery. During the Zhou Dynasty, there were improvements in terms of agricultural production, through the introduction of new cultures and the refinement of ploughing techniques.

<sup>1</sup> The Zhou Dynasty (or Chou) represents in chronological order the third dynasty that succeeded the Xia and Shang Dynasty, as well as the longest and most important in terms of territorial expansion. Fu, P., (1971). The birth of the accounting practice in China under the Zhou Dynasty is linked to the book Rites of Zhou which, although of unknown author, the idea was attributed by various scholars to the emperor of the Zhou Dynasty. The book describes the administrative structure of the Government of the kingdom. Aiken and Lu, (1993).

The land was owned by the State, there were square portions, divided again into smaller squares delimited by a netting of orthogonal lines on the four sides of the main square. The smaller portions were given in enjoyment to the peasant families who were obliged to collectively cultivate the larger portion and to deliver the harvest to the State.

The administration of the Kingdom was organized by means of six control offices placed under the king, that were called as follows: Paradise, Spring, summer, autumn, winter and Earth. The functions of the Paradise Office were similar to those of a prime minister.

In fact, the task it carried out was the financial management of the state, i.e. management of revenue and expenditure and their Accounting, through the drafting of some reports (which we can define as the first forms of financial reporting) that were then delivered to the emperor<sup>2</sup>. The Accounting system in use at the time of the Zhou Dynasty was obviously a rudimentary system, realized through numbers written on one column, where the revenues and expenses of the goods were recorded.

In Chinese language, the characters 入 *ru* (revenue) and 出 *chu* (expenses) were used for this purpose. The collection of data was carried out on a "sort" of newspaper book, called *Cao Liu*, in sequential order of manifestation, which was defined by Chinese as water flow Accounting<sup>3</sup>. The operations were transferred monthly or every ten days in another book, called *Zong Qing*, which has the function of a ledger. The periodic closure of the operations allowed the calculation of the "budget", called 预 *yu*, according to the following equation: 入 - 出 = 预.

This simple and straightforward Accounting methodology reflects the "philosophy", in terms of Accounting, of the Chinese feudal Society of that time, with the aim of calculating the profit of the Dynasty Empire.

The first real development phase of China, both in economic terms and Accounting system, took place during the settlement period of the Qin and Han dynasties (221 BC – 221 AD). Under these dynasties began to develop a collection of data method for the "private" sector. In fact, next to the items written under the label of 入 and 出, they put those of 收 *shou* and 付 *fu*, analogous to their predecessors, but applied for non-governmental uses.

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<sup>2</sup> Under the Zhou Dynasty, revenue came from nine different types of taxes, while the items of expenditure were composed of nine voices. The nine was considered, in fact, a lucky number. Aiken and Lu, (1993).

<sup>3</sup> "...it is an image of a stream flowing as transaction were maintained in the books sequentially". Jun Lin, (1992).

The newspaper book, where the daily operations were recorded was still *Cao Liu*, while the *Zong Qing* also absolved the functions of ledger (Gao and Handley-Schachler, 2003). Under the Qin Dynasty the currency<sup>4</sup> was unified and this represented an important evolution in relation to the monetary measurement of trade.

There was not a real concept of profit, caused by the extremely poor conditions of the society and by the feudal system with which the dynastic monarchies were organized, that did not stimulate the development of private activities by the subjects.

With the Han Dynasty (206 BC – 220 AD), by Emperor *Liu Che*'s will, the Confucianism was officially adopted as political ideology.

This represented an important event also for the Accounting system, since, as confirmed by many scholars, the Confucianism strongly affected the Chinese culture. (Hofstede and Bond, 1988); (Van Hoepen, 1995); (Gao et al. 2003); (Ayhan, 2007); (Xu et al, 2013) The fundamental aspects of Confucius's philosophy were based on a hierarchy of the social system, with a rigorous definition of rights and duties within society<sup>5</sup>.

Confucius's philosophy was therefore based on an idea of balancing, rejecting material interests and collectivism. As indicated by scholars who have devoted themselves to researches about the effects of Confucianism in Chinese Accounting system, the most important example is the dualism between 义 *yi* (fairness, virtue) and 利 *li* (profit) that can be summarized in the sentence (in use at that time) "Nobles think about virtue, while common people think about profit". The idea of profit was banished from the Confucian dogmas, consequently the merchants and accountants (Accounting was associated with commercial activities) were subjected to a strong discrimination in the Chinese social system. This led to a cessation in the evolution of the Accounting system in China, which remain, for many centuries, in the form of single entry bookkeeping.

In the Tang and Song Dynasties periods (618-1279 AD), there was a step forward in terms of economic development.

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<sup>4</sup> The currency in China was born at the time of the Shang Dynasty, although it did not exist in the form of money as commonly understood, but as strands of ten shells called "Cauri" then later became fake shells in bone, mother of pearl and bronze. Only under the Zhou Dynasty there were coins made of copper and bronze, that imitated in the form some objects of common use or animals. Later under the Han Dynasty coins acquired a circular shape with a hole in the centre.

<sup>5</sup> "The following are the key principles of Confucian teaching: 1) The stability of society based on unequal relationship between people. 2) The family is the prototype of all social organizations. 3) Virtuous behaviour toward others consists of treating others as one would like to be treated oneself: a basic human benevolence – which, however, does not extend as far as the Christian injunction to love the enemies. 4) Virtue regarding one's tasks in life consists of trying to acquire skills and education, working hard, not spending more than necessary, being patient and persevering." Hofstede, G., Bond, M.H., (1988).

The society slowly began to evolve, the production of goods and trade underwent a new positive impulse and the Accounting system were influenced as well.

In fact, the old method of the three columns used for the final balance of the accounts was abandoned in favour of the four-columns method.

The four-columns method, called *shizu jiesuan*, consisted of four elements representing the largest categories of transactions that were to be balanced, such as:

previous balance sheet + new revenues – expenses = current balance sheet.

The system of Accounting books that developed at the end of the Tang Dynasty and which continued during the Song Dynasty were constituted of three types: *Cao Liu* that already existed at the time of the Zhou Dynasty and where they recorded transaction in sequential order (a rudimentary writing in first note). At the end of the day the operations were transcribed in the newspaper book, *Reqing Bu* and later summarised (historians indicate a temporal average from ten days to one month) in another newspaper book named *Tenqun Bu*<sup>6</sup>. The four-column system remained in use even during the Ming Dynasty (1368-1644 DC) and Qing (1644 – 1911 AD), both for the management of the state and private properties, and the method of collection of data continued to be the single-entry bookkeeping. Despite a few steps forward, in this Chinese historical phase, manufacturing and trade activities were still in an embryonic state and were related to small entities.

Therefore, the single-entry bookkeeping system still represented an efficient way of collecting data. It is during the Ming Dynasty that some fundamental evolutions began to realize and that will allow the replacement of the single-entry system with the double entry one, already used in Western countries. The first was the three feet Bookkeeping system (*Sanjiao Zhang*). *Sanjiao Zhang* was still composed of the three-book system, and used single-entry bookkeeping, except for non-monetary transactions that followed a technique that we can define as a rudiment of the double entry system<sup>7</sup>.

This represented, although in the embryonic state, a method that allowed to record the movements of the assets and liabilities of the companies.

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<sup>6</sup> In literature, we can see how often the books were called with different names, such as *Cao Liu* was also called: *Ben Zhang*, *Cao Pi*, *BU*, *Zhang*. Aiken and Wei (1998).

<sup>7</sup> For example, if the warehouse was used to settle debts, the writing was: *Shou*(revenues): silver from stock (eg: silk) *Fu*(expenses): Silver to creditor. With this type of writing one wanted to record a decrease in the stock and on the other hand a decrease in the debts. The passage to the currency account (silver) was due to the fact that in traditional China the accounting, as seen, was focused on money flows (revenues and expenses). In fact, in cases transactions were directly managed with money, double detection was not necessary, but it continued to use the single-entry system. Aiken and Lu (1993b).

Despite its hybrid nature (that is why it was called three feet or three legs or tripod), which involved considerable risks of incurring errors during collecting data, it represented the connection bridge for the double entry system that was formally and materially realized by means of the *Longmen Zhang*, whose invention was attributed by Chinese historians to a merchant from the *Shanxi* region, *Fu Shen*, between the end of the Ming Dynasty and the beginning of the Qing one<sup>8</sup>. The operation method of *Longmen Zhang* still implied the usage of three books, two of which were already in use at the time of the Tang dynasty<sup>9</sup>. The fundamental differences with the three legs system were that all accounts were grouped into four distinct categories:

1. *Jin*: all accounts receivable, sales and revenues in General;
2. *Jiao*: all accounts related to costs and outputs;
3. *Cun*: accounts related to changes in assets;
4. *Jha*: accounts related to changes in capital and liabilities.

The recordings in the newspaper book followed the double entry criterion and were recorded in the same amount under 收 *Shou* (revenues) and 付 *Fu* (expenses), respectively at the top and at the bottom of the newspaper book.

At the end of each Accounting period, which in ancient China followed the lunar calendar introduced during the Xia Dynasty (2206 BC – 1766 B.C.)<sup>10</sup>, the closing of the accounts was carried out, in order to verify the balance between the parts composing the *Zong Qing* and forming the following equation:  $Jin - Jao = Cun - gai$

Following the *Longmen Zhang* was the *Tian Di He Zhang*, also called by the historians four feet (or legs) bookkeeping system.

This system appeared around the middle of the Qing dynasty period, at the beginning of the eighteenth century. In this system, great importance was given to the ledgers,

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<sup>8</sup> Jun Lin (1992) argues that the double-entry bookkeeping system was developed by the Chinese autonomously in the final stage of the Ming Dynasty (1368-1644) and therefore have not been imported from the West, i.e. derived from the Summa de arithmetica, geometry, Proportionate Proportionality of Pacioli. "However, it is sufficient to assert that double entry bookkeeping was only invented in Italy, because there is much evidence to suggest that double-entry method was in use in China around the turn of the sixteenth century"

<sup>9</sup> The books were: *Cao Liu* and *Zhong Qing*.

<sup>10</sup> According to the lunar calendar one year was divided into 12 months by 29 or 30 days each.

Each month was divided into 3 periods of 10 days each called Hsun. The concept of the week was introduced much later with the introduction of the Christian religion in China. The lunar calendar was maintained during the various dynasties until the establishment of the Chinese Republic of 1911 when it was replaced with the solar calendar, although, particularly for agricultural activities, the lunar calendar continued to be used. Fu, P., (1971).

distinguished by the nature of the cost (eg: ledger of Staff, of purchases, of sales and a book called "Miscellaneous", that embraced all the accounts previously indicated).

One of the reports that were written was the *Cai Xian jie*, that can be defined as an income statement in which all sales revenues were reported at the top, while all expenses (including taxes) were written at the bottom. In the case of profit, the amounts in the upper part exceed those of the lower part and vice versa in the case of losses. In addition to this, the *Cun Gai Jiece* report (inventories and debts) was drawn up.

The substantial difference that can be found in relation to the *Longmen Zheng* is that in this case the calculation carried out at the end of the period was aimed to balancing the value of the inventories based on the following equation:  $Cun = gai + \text{period result (profit or loss)}$ . The obtained balance was called *Tian Di He* which meant "to let heaven meet the earth." The *Longmen Zheng* and *Tian Di He Zhang* remained the ones in use until the First Opium War, begun in 1840, and which is considered historically the beginning of the modern age in China. However, only after the Second Opium War ended in 1860, Western accounting systems began to be applied in China, particularly in the banking sector. The history of the Accounting evolution from the traditional China's period to the application of the Western method of double-entry bookkeeping was a very long path, developed slowly during the alternation of the various monarchic dynasties and related to the economic development of the country and to some cultural aspects, that have played a key role in influencing the Accounting system, first of all the Confucianism, but also religion (Buddhism) and ancient beliefs (Feng Shui)<sup>11</sup>.

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<sup>11</sup> Gao and Handley-Schachler (2003) studied the effects of the influence of Confucianism, Buddhism and Feng Shui in the evolution of Chinese accounting practice. For example, the realization of the "balance" that we have seen to be one of the purposes of the application of the accounting practice in ancient China is linked to the ancient Chinese cosmic ideology of feng Shui, characterized by the duel by two opposing forces (yin and yang) that affect and balance the life. The balancing of opposing forces, also understood as "mediation" in conflicts, in order to maintain harmony, it is also one of the Confucianism's principles, like some elements of the Buddhist religion, such as the rejection of profit and material desires ("People's desires are the roots of Evil"). The names of Chinese accounting techniques reflect the above concepts, such as *Tian Di*, which meant "to meet the heavens with the earth". Finally, conservatism, understood in the Confucian philosophy in aversion to change (with the purpose of protecting the social order), has represented an element of influence in Chinese Accounting system.

## 1.2 The first use of Western's double entry bookkeeping (1840-1949)

According to historians, the first Opium War marked the beginning of the modern era in China, that is, the transition from empire to semi-colonial State.

In terms of Accounting system, in this period the methods coming from the West began to be introduced. At the end of the Qing Dynasty (second half of 1800) some public offices and banks had already been used Western Accounting methods.

Initially the use was mixed, it means that the accounts were then transformed into the Chinese shape, according to the method of the four columns (four feet Accounting).

Until the beginning of the twentieth century, the traditional Chinese Accounting methods and the Western systems coexisted, then there was an actual predominance of the second on the first with the Xinhai Revolution in 1911<sup>12</sup>, followed by the birth of the Chinese Republic and the consequent end of the millennial celestial Empire.

The Western Accounting system was first applied to the banking system (also by the Bank of China), then to other sectors, thanks to an effort to spread out the Accounting culture realized also by the establishment of rules for accountants in 1918, which implied the mandatory examination to obtain the qualification of professional public accountant<sup>13</sup>.

Although there have been several Accounting laws<sup>14</sup> in this period, there was not neither a substantial evolution in the private sector, nor a full adoption of Western practices.

A sort of hybrid system was created, where it was indicated that the values of *Cai* and *Gai* had to coexist and have the same value, but there was not a complete passage to the Western system, which was used only at managerial level in the companies controlled by Kuomintang (nationalist Chinese party) and in the foreign companies.

This system persisted until 1949, when the surrender of the nationalist army of the Kuomintang, then refugeed in Taiwan, occurred and there was the rise to the power by

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<sup>12</sup> The revolution was led by Sun yet-Sen, founder of the Nationalist party Kuomintang. With the constitution of the Republic of China, the country was divided into various areas controlled by a local lord, said "warlord", and such remained until the death of sun-yet-Sen, since his successor, Chiang Kai-shek, with the military victory over the warlords succeeded in formally unifying China. Meanwhile, China was preparing to face not only the civil war, which was between the nationalist forces of the Kuomintang and the Communist ones of the Chinese Communist Party (founded in 1912 in Shanghai), but also a conflict against Japan, in 1931 with the Japanese invasion of Manchuria and Shanghai and ended only after the end of the Second World War in 1945. After the Sino-Japanese War, they resumed internal conflicts until the defeat of the nationalist Army, refugeed in Taiwan, followed by the proclamation of the People's Republic of China in 1949.

<sup>13</sup> The first book in Chinese language, that dealt with the Western double-entry bookkeeping system (the Italian one) was written in 1905 (Lian Huan Zhang Bu), therefore was some years before the Xinhai revolution.

<sup>14</sup> Accounting Law (1935); Auditing Law, Budgeting Law and Final Accounts Law (1938).



the Communist army. The birth of the People's Republic of China in 1949 opened the first phase of constitution of centralized economy with application, even at the Accounting level, of the Soviet model.

### **1.3 1949-1957: the adoption of Soviet's model**

The first phase of the People's Republic of China, which includes three years of reconstruction and the first five-years plan<sup>15</sup>, shown a substantial development of the country's economic growth rate and a substantial restructuring of the State organization, of the foreign companies and of the companies that were previously under control of the Kuomintang party. First of all, foreign companies and those which were controlled in the past by the Nationalist Party were confiscated and transformed into state-owned companies (SOE's), while private activities, were reorganized as cooperative (Coe's).

A new economic/productive/business structure was going to be outlined under the hegemony of Mao. From the Accounting point of view, there was a political debate about the relevance of Western accounting practice with Communist ideology.

The rejection of Western Accounting system prevailed, as it is linked to capitalist ideology and therefore, by its nature, not adherent to the new political and social structure that the country was making under Mao. In fact, in 1953, the new Chinese Accounting system adopted the Soviet model<sup>16</sup>. As part of this Accounting reform, were issued the Uniform Accounting System (UAS) principles, which were different for each industrial sector (such as manufacturing, agriculture, banks, transport and trade).

Each set of UASs was delineated based on the characteristic production typology and the operational plans of an industry and the external business information was prepared primarily to allow the State to achieve part of the national economic plan and to monitor its implementation.

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<sup>15</sup> The Chinese Constitution says, "the period from the foundation of the People's Republic of China to the advent of the socialist society is a period of transition. The fundamental task of the State during the transition period is to progressively develop the socialist industrialization of agriculture, crafts, industry and capitalist trade ".

<sup>16</sup> The real object of the debate was the dualism of capitalism – communism, within the Accounting system was conceived as an instrument of capitalism. As some scholars of the time argued, "Socialist accounting should be based on Marxist political economy and therefore the main questions were: whose interest does accounting serve? And who controls accounting? " Xin and Huan cited in Ezzamel M. et al (2007); Accounting theory serves the capitalist classes and should no longer be allowed to continue in today's New Democratic Society ", Yan, cited in Ezzamel, M., et al., (2007).

In other words, the UASs were instruments of the collection of statistical data, used by the State for planning and controlling economic development.

All the companies had a strict obligation to observe the relevant UASs.

The UASs were different from industry to industry in terms of items and Accounting procedures because of the specificities of each sector, but they were all quite similar in the subjects of postulates and implementation purposes.

Each UASs governed the following areas: general principles, budgetary uniformity, chart of accounts, Accounting books, Accounting procedures, scheme of the organization of the accounts. The most important peculiarity of the UASs was their normative and procedural nature. The UASs were substantially different from the international Accounting standards. (Blake, 1995). They had been introduced to be applied in the context of a planned central economy and had completely different goal than those applied for external business information of a market economy.

The adoption of the UASs was followed by the introduction of a fund Accounting system. This new system introduced an Accounting concepts and new principles in line with the state system of resources allocation and management control.

The old Accounting methods hitherto used was replaced by a new equation of the new Accounting system, based on funds: use of funds (fund application) = Sources of funds (Fund resources). The word "fund" was the monetary expression of the properties, products, materials, and financial activities used in the production process.

Supplies of funds were the channels through which the funds were gathered, while the use of funds meant the forms, the usage or the allocation of the funds, such as properties, products, materials and financial assets.

The total of the funds used had to constantly match the sources of the funds at any given time. The funds were classified into three categories: fixed funds, current funds and specific funds. The total of the assets had to be the same to the total of the funds for each category and each movement had to comply with the following equations:

Fixed Assets = Fixed Funds

Current Assets = Current funds

Specific Assets = specific funds

Among the types of found sources reported in the balance sheet, the most important were the state funds, while other funds, such as enterprise funds and bank loans, accounted for an irrelevant percentage of the total.

An income statement, followed by a second analytical document showing the cost of the produced goods (product cost statement)<sup>17</sup>, was accompanied by the "balance sheet".

All costs, including administrative expenses and those relating to the sale of products, were included in the cost of production, since the concept of variable cost was unknown to the accountants of that time. Some typical characteristics of the fund Accounting system that are consistent with the nature of the national economic system must be highlighted: there were no intangible assets and the land, owned by the state, was not recorded among the assets (Chan and Roterberg, 1999).

One of the peculiar aspects of the Accounting system of this period was the participation of the workers in the determination of the cost of the goods produced.

The smallest production unit (a team or a "shift") was used as the "base unit" for calculating production costs. Workers were assigned the task of controlling the consumption of raw materials, working hours and other expenses, as well as production output. The underlying purposes of this *modus operandi* were mainly two.

Firstly, to reaffirm the primary role of workers in companies operating in a centralised market economy, which had to participate in the management of the company.

Secondly, to control and reduce production costs through a comparative method and emulation of the productive efficiencies between different units.

Generally speaking, in this period the development of the Accounting system was adequate and coherent with the political and economic system to which it was enslaved.

In the university field, significant progress was made during this period.

Many universities began offering year degree courses in business matters and numerous colleges were economically and financially oriented.

Because of the political climate of that time, the subjects taught were translated by Russian language and heavily influenced by the Soviet model.

The Accounting generally accepted in the Western world was completely banned and the textbooks of this subject were destroyed. All the university students were obliged to learn Russian as a foreign language and the teaching of the English language was abolished. The result of this State practice was that both academics and professionals remained completely unaware of the developments in the Western world until China reopened its doors to the west, more than twenty years later.

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<sup>17</sup> What in our Italian system is defined in the income statement as the cost of goods sold.

## **1.4 1958-1962 Maoism and “The great leap forward”**

The phase of the Maoism has this appellation because it represented the period when the political work of Mao, and therefore its effects, were more "intense" in China.

This phase was constituted by a series of events that affected the economy of the country and on the Accounting system. The first phase is the period of the so-called "adjustment campaign" succeeded by the "hundred Flowers" period, where under the slogan "Let a hundred flowers bloom," let a hundred schools of thought contend", Mao had promoted a phase of reflection inviting the party members, officials, intellectuals to make known their opinions and criticisms about the Chinese situation.

From this context emerged an intense debate in which took part a great number of people. The participation to the debate exceeded the "expectations" of the promoters so that in the middle of 1957 the Chinese Communist Party launched the "campaign against the right-hand opportunists" who had the purpose to put under accusation all those who had attacked the communist regime, taking advantage of the freedom of expression granted. In 1958, two radical programmes were launched, the movements of popular municipalities and the Great Leap Forward (GLF).

The underlying aim of these two programmes was to increase the rate of economic development. The strategy that was adopted was focused on mobilising certain social classes, such as farmers and workers, in order to transform society into a set of productive activities. The two programs ended in a complete failure.

The Great Leap forward represented the attempt to create a National socialist conscience not through the indoctrination of the masses, but by making the Chinese able to develop this consciousness autonomously. The atmosphere of fear and intimidation during this period had negative consequences for the Accounting. These systems had been designed to provide fundamental statistical data for the centralized planning process; their deterioration resulted in the loss of many information that was previously easily obtained. The great leap forward has introduced negative changes in the planned economy, management control systems and administrative structures.

The political climate of intellectual repression created against to the professional classes, and the fear of expressing their ideas spread among the population, caused considerable damage to management control systems and Accounting system.

During this period, it began to affirm the idea that if it was possible to stimulate the enthusiasm of the population through political movements, then the redistribution of the

power towards the less elevated groups of workers would generate a miraculous growth of efficiency and consequently an increase in productivity.

The government then moved in the direction of reducing central control, facilitating working practices. The Ministry of Finance introduced simplified rules and procedures in the field of reporting Accounting systems. The chart of accounts was reduced from 85 to 44 accounts. Management control systems and Accounting systems were perceived as limiting factors to the population and, for this reason, were eliminated in large part.

The habit of involving workers in the collection and measurement of product cost information was ceased, since it required time and was considered to be a non-productive activity, carrying any added value to the production of goods.

In other words, the time spent on this activity was seen as wasted and workers and employees preferred to participate in productive activities rather than dedicating themselves to Accounting practices and office activities, also because the latter were considered to be typical activities of intellectuals and professionals, whose position within a working society was not very clear (Cheaneaux, 1963).

It became common practice to record excessive productive efficiencies, thus gaining the compliments of the superiors and consequently getting promotions.

During the "Great Leap Forward" numerous Accounting experts were dedicated to other activities, often manual ones. Accounting rules and procedures were ignored and since the Accounting records were limited, the accuracy of the information depended on the professional seriousness of the employees. The result was the inability to measure the real state of the national economy. The development of the Accounting system received a hard setback: the degree courses in Accounting matters were closed, the universities were closed or merged with others, the evening and distance teaching courses in economic and business subjects were eliminated, while the Accounting academics and students were required to spend more time engaging in productive activities in the companies.

## **Chap.2 THE FIRST REVOLUTION OF CHINESE ACCOUNTING SYSTEM**

As a result of the "Great Leap Forward", to face the condition of national crisis, the Government was forced to take drastic measures.

The construction of great works was ceased, the industrial production was reduced and the workers, who had gone to big cities in order to find a job, returned to their villages in two stages, in 1961 and 1962. At the end of 1961, a document called "Twelve articles on People's communes" was outlined and the implementation of this document marked the end of the "Great Leap Forward". The importance of Mao within the Communist Party formally decreased. Mao was forced to perform an act of self-criticism during the conference of the seven thousand executives of the party, held in 1962.

During the conference, Mao admitted his responsibilities for the mistakes and disasters related to the Great Leap Forward. As a result, Mao was asked to renounce to his authority in favour of his colleagues and to take a secondary role in the files of the Chinese Communist Party. Between 1963 and 1965, the President of the People's Republic of China at that time, Liu Shaoqi, the general secretary of the Chinese Communist Party, Deng Xiaoping and other leaders of the party put in place a staggering economic recovery reform (the Liu-Deng program). Following the Liu-Deng program, the communes were reduced to a more easily manageable size and the distribution of incomes was linked to the performance of the peasants. There was an attempt to relaunch an economic development strategy based on a more balanced relationship between agriculture, light and heavy industry. The Liu-Deng programme proved to be efficient enough to bring the country's production levels back to the same levels that existed before the "Great Leap Forward". Mao continued to see himself as the true leader of the party and spent the next three years planning his return to the political scene and the elimination of his political enemies. Unfortunately, Liu and Deng were destined to become victims of the "Cultural Revolution"<sup>18</sup>. By the way, the short period of activity of Deng Xiaoping represented, even from an Accounting point of view, a phase of recovery.

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<sup>18</sup> "The Cultural Revolution was officially launched to achieve a cultural change, but it took the form of a struggle for political power. The political implications were less evident than the struggle itself, and among these implications those related to economic policy made their appearance relatively late. " Gray (1969) p. 113.

## 2.1 1963-1965: the recovering phase with Deng Xiaoping

During this period was highlighted the central role of Accounting system and the specific Accounting practices and principles for each sector were introduced again.

Many of the Accounting practices eliminated between 1957 and 1959 were reintroduced. In 1963, the government issued the Regulations on Duties and Rights of Accounting Personnel, aimed to protect the accountants against interferences in their work and ensuring the quality of the Accounting information. New impulse was given to the teaching of Accounting. In 1965, 18200 students were studying business economy, while in 1962, they were only 2400. The period preceding the "Great Leap Forward" bequeathed the use of the new double-entry bookkeeping system, the so-called increase/decrease method. Since the debit-credit method had been imported from the "World of the Rich", it was not considered suitable because people think it is difficult to understand<sup>19</sup>.

It was stated that the method of "increases and decrease" was simpler, less specialized and in harmony with the revolution. This method used increases and decreases as determinants for Accounting records. It included two classes of accounts: the fund source or revenue accounts and the fund applications or expense accounts.

If a transaction implied the use of an account related to fund source or revenue account and another related to fund application or expense account, an increase (or decrease) of each class of the accounts was recorded. If an operation provided only one class of accounts, as a result there would have been an increase in that class and a decrease in another account of the same category. The method based on increases-decrease was used in small and medium size companies. The fundamental principles of this method were substantially analogous to the ones of the debit-credits method.

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<sup>19</sup> Lefebvre and Lin (1990) Note that the two methods, however, are substantially similar:

"In fact, the increase – decrease and debit – credit methods are quite similar. The basic principle of the increase-decrease is very simple. It may be expressed as "if a transaction affects the accounts on both side (Fund application or fund source), an increase in an account must be accompanied with a decrease in other account; If a transaction affects the accounts on both side (Fund application and fund source), the accounts from both sides must be increased or decreased simultaneously ". The two scholars say that the increase-decrease method may seem simpler as is less abstract than the concepts of "debt" and "credit", even if the basic principle remains the same.

## **2.2 1966-1978: Cultural Revolution and drawbacks in Accounting system**

The great proletarian Cultural Revolution occurred from the beginning of 1966 until the death of Mao, which took place about ten years later.

This extraordinary political and mass movement, which involved the entire population, was largely caused by Mao and mainly aimed to eliminating its political opponents, in order to allow him to regain his dominance position within the communist party.

During the recovering phase, the crisis caused by the Great Leap forward was partially solved. Liu Shaoqi and Deng Xiaoping had successfully implemented a series of policies aimed to restoring social cohesion and economic productivity, such as the reintroduction of the statistical system, technical regulations, the return to a privatisation of agricultural farms and new incentives brought on the industry sector.

From Mao's point of view, these reforms have created conditions of inequality, specialization and hierarchy, therefore were strongly incompatible with his socialist vision of society. As a response to this situation, Mao built his revenge on three elements, or groups of Chinese society: – The disadvantaged young people, who later were known as the "Red Guards"; – opportunistic intellectuals, who provided Mao with "theoretical justifications" in support of the Cultural Revolution; – The Army, on which Mao still had considerable influence. The Cultural Revolution was launched by Mao as a mass movement against old ideas, old culture, old habits, and old traditions in order to create a new and healthier cultural environment. It involved students, workers, peasants and other social groups and turned into a social class struggle against the restoration of capitalism. Mao and his allies have directed the movements of the masses against the Communist Party and the governmental hierarchies, in particular against Liu and Deng, and demanded the confiscation of their power, as they were taking the path of capitalism.

The Mao's group quickly established on the leadership of the party.

The Constitution of the People's Republic of China was modified, the "Popular Democratic dictatorship" was replaced by the "proletarian dictatorship".

This switching of the power went out of control and quickly degenerated.

There were violence and chaos spread throughout the nation.

The masses were divided into warring factions in the struggle to acquire power.

The party's structures and government bureaucracy remained paralyzed.



Liu and Deng, accused of being the leaders of the bourgeois command, were arrested and detained. Liu died in prison in 1969, Deng was exiled to manual labour in a remote province of China. The Chinese economy deeply suffered during the Cultural Revolution. There was the abandonment of gradual economic development and the re-emergence of the destructive policy adopted earlier than the Great Leap Forward.

This strategy was again directed towards the heavy industry, creating serious distortions between the various sectors of the economy. Slogans such as "The revolution comes before production" or "better socialist weeds than capitalist plants" have restricted industrial activities, since the possibilities of the management body to handle problems were seriously limited by the fear of political reprisals.

Before 1977, productivity growth was nothing. According to official statistics, during this period, the growth of per capita income was slow and the growth of living standards was even slower. At the end of the Cultural Revolution, the Chinese economy was on the verge of collapse. (Lu, 1992). During the Cultural Revolution, the development of Accounting had another setback. Professionals and academics were exiled in the campaigns to carry out manual works. The teaching of Accounting in universities was completely abandoned for about ten years. Managerial control practices and Accounting procedures were considered incoherent and conflicting with the spirit of the Cultural Revolution. In many companies and enterprises, balance sheet was drawn up in the way that was thought to be more appropriate to the diffusion of the principles of the Cultural Revolution. Where no Accounting practises were held, the method of drawing up balance sheet "without the support of Accounting books" was often used<sup>20</sup>.

In the Maoist phase, the centralised economy planning was the main instrument for balancing demand with the supply of goods, in this sense companies, and accounting, had merely an instrumental role in obtaining that balancing.

Entrepreneurial and individual interests were subordinate to the interests of the State<sup>21</sup>.

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<sup>20</sup> In this stage, the practice of the so-called "Accounting without books" was spreading out, i.e. the elimination of books and ledger books.

<sup>21</sup> The Chinese Constitution, like the Russian one, said that, in addition to the Leninist principle of the uniqueness of the power of the state, there is also a distinction between the "good" Chinese, the renmin (i.e. those who approve and support the socialist construction), and the rest of the Chinese, the guomin. This distinction was used by Mao to "justify" the centralization of state power, meaning that if the state power had been decentralized it would no longer be represented by remim but by the guomin. In this sense, the Maoist state organization can be interpreted as "deconcentrated centralization", where there was no transfer of decision-making power, since central power executives were sent to the various territories of the state to direct the local executives. Gibelli and Weber (1983).

After the death of Mao Zedong (1977), in China began the so-called "transition period", under the guidance of Deng Xiaoping that will bring China from a centralized socialist economy to a socialist market economy<sup>22</sup>.

### **2.3 The Great Open-Door Policy of Deng Xiaoping**

The peculiar characteristic of the political system of the People's Republic of China is the absolute control exerted on the country by the Chinese Communist Party led by an absolute leader. The first was Mao Zedong, then Deng Xiaoping and later Jiang Zemin. The People's Republic of China is a "Popular Democratic dictatorship" country, founded on the alliance between peasants and workers under the leadership of the Chinese Communist Party. The CCP's central directory defines primary policy strategies, while the supreme authority resides in the Politburo (Chinese parliament) and its executive committee, which has always been guided by a charismatic figure.

The National People's committee (NPC) and the popular committee at provincial and local level are the legislative bodies. The Government's administrative function is exercised by the State Council at national level and by governmental bodies at provincial and local levels. This political and administrative framework was established in 1950, designed for a country characterized by a planned market economy and controlled by a central government, where there were only two types of companies: state owned enterprises, and collective owned enterprises. There was neither a private sector nor a market. Since the beginning of economic reforms and the adoption of an open-door policy in 1979, the Chinese economic framework and the companies' control structure have undergone significant changes. At the III Plenum of the XI Chinese Communist Party's Central directory, in December 1978, Deng Xiaoping was again placed at the head of the party. It was also decided that the CCP's main objective should be the pursuit of economic development and modernisation. Deng's attitude towards political control and political change, summarized as "*Deng Xiaoping theories*", gave a new form to the political scene of China<sup>23</sup>.

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<sup>22</sup> Liu and Eddie divide the period from 1949 to 1978, i.e. the phase of centralized socialist economy in 5 phases: 1) infancy (1949-1956); 2) suspended (1957-1961); 3) recovery (1962-1965); 4) catastrophe (1966-1976); 5) Transition (1976-1978).

<sup>23</sup> During the third Plenum, the Maoist thought was harshly criticized for its disastrous consequences for the country's economy. In this context, Deng became a symbol of the need of modernisation, through four actions (the so-called four modernisations) in the fields of: agriculture, industry, defence and R&S.

The reform with greater international resonance was the so-called "open Door Policy", which meant opening Chinese market to foreign capital.

However, there were also other innovations, including the reform of public enterprises (SOEs – State owned enterprises), of the banking sector and the reconstitution of the Chinese Accounting Society<sup>24</sup> (CAS) after more than thirty years.

There was also the admission of the China to the United Nations and its Security Council as a permanent member. Proceeding in a chronological order, the open-door policy represents one of the biggest "breaks" with the past. In fact, with the aim to make the country more attractive to foreign capital and in order to import new technologies from the west, four areas characterized by special incentives for foreign investment were created, called Special Economic Zones (SEZs)<sup>25</sup>. In the SEZs, foreign companies could enjoy tax benefits and favourable legislation. The open-door policy was also implemented through the entry of Western scholars, who were involved in projects and seminars held by Chinese universities and also the emigration abroad of Chinese Accounting students aiming to learn Western methodologies and practices in order to develop the new Chinese Accounting system that would have been introduced in the following years (Bromwich and Wang, 1991). Before talking about the important legislative innovations that have shaped the development of Accounting in China, it is necessary to make a brief introduction to the sources of the Accounting (but also of the companies) regulations in China.

There are three hierarchical levels. The first is the National People's Congress, that has priority importance, as it promulgates the laws. At the second "step" of this hierarchy is the Council of State, which has the enactment power, exerted through the emission of regulations and the development of the conceptual framework on which the bodies placed at the third level will work on. In fact, the Council of State appoints the various ministries to the issuance of specific Accounting rules for each "industry"<sup>26</sup>, according to the legislative framework established by the Council. The administration and implementation of the Accounting rules are given to the Ministry of Finance (MOF), which co-operates with the Chinese Accounting Society (CAS), the standard Chinese setter that was re-established in 1980 after its elimination by the Maoist policy.

There were many developments in Accounting System during this period.

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<sup>24</sup> The Accounting Society of China was originally founded in 1950, but then was suppressed by Mao Zedong.

<sup>25</sup> The first four SEZs were identified in the following areas: Shenzhen, Zhuhai, Shantou and Xiamen.

<sup>26</sup> "Industry" is referred to the Accounting regulatory areas present in 1985 that can be indicated as: heavy industry, trade, transport and communication, financial services, construction, tourism, agriculture, urban development.

The Uniform Accounting Systems (UASS) were substantially revised.

The UASs were modified in order to include new accounts and new methodologies.

For the first time, new financial statement appeared: bank loans and corporate funds (non-distributed profits) in the balance sheet and income taxes and undistributed profits in the income statement. Secondly, a state-controlled audit system was established.

A scheme of income distribution was defined between the government and the companies.

There was also the introduction of income taxes. However, there was no independent professional figure that could certify the regularity and the fairness of the balance sheets drawn up by the SOEs. The government, during the Fifth National People's committee, held in December 1982, established the professional figure of the General Auditor and similar positions were placed at each provincial and local governments.

The audit system established by the State was essentially aimed to ensuring the correct collection of tax revenues. The first implementing law of the open-door policy phase was related to the "joint ventures using Chinese and foreign investment"<sup>27</sup> and was adopted at the fifth National Congress of the People in 1979. Based on this law, the MOF promulgated in 1985 the "Accounting regulation for joint ventures using Chinese and foreign investment", which represented the establishment of the modern Chinese Accounting system aimed to comply with international Accounting rules.

An important step towards harmonization was in the context of financial reporting by overcoming the fund-based system in favour of the western accounting equation:

$$\text{Assets} = \text{liabilities} + \text{Equity}$$

Concerning reporting methods, the law stated that joint ventures had to prepare and sent to the administrative and fiscal offices of the local Chinese government the following three documents:

- Balance sheet
- Income Statement
- Cash flow statement

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<sup>27</sup> The type of joint ventures that has been regulated by the law was only the so-called equity joint ventures, i.e. foreign/Chinese mixed-capital company. In this sense, the accounting rules referred to this corporate figure and not to the others that later appeared, such as the wholly foreign-owned ventures, a company with total foreign capital and the contractual joint ventures, which were characterized by a distinction in the contributions provided to the companies by the parties. Generally, the foreign party conferred machinery and technology while the Chinese part provided the raw materials, the workforce and the land used by the enterprise. These companies used these Accounting rules until 1992, when Accounting legislation was readjusted (issuing the Accounting regulation for enterprises with foreign investments).

The schemes that the joint ventures had to use in preparing these documents and which were established by the MOF (Chinese Ministry of Finance) were similar to those in use in Western countries<sup>28</sup>. In addition to the substitution of the Fund Accounting, there were other changes in linked to this first reform (it is necessary to emphasize that this law was only addressed to equity joint ventures). Firstly, the introduction of the concept of capital that implied the recognition of companies as entities independent from the State.

Secondly, the classification of costs, such as direct costs, general expenses and labour costs. Moreover, the obligation to draft the financial statement (or liquidity) and the introduction of methodologies to record the exchange gains/losses, intangible investments and organizational expenses. Considering the legislation for Chinese companies, the first source was the Accounting law of the People's Republic of China issued by the National People's Congress in 1985. The law was constituted of 6 chapters and 31 articles and became mandatory for all state enterprises, government agencies and the army.

There were two other regulations of the Council of State, such as: Regulation on cost management of state-owned enterprises and Tentative Regulation on fixed assets depreciation for state-owned enterprises. In this period, the Accounting practice of the "collective ownership" enterprises was based on the Accounting rules established by the Ministry of Finance depending on the sector in which they were operating.

There were, in fact, 40 different regulations. A further novelty aimed to stimulating the economic development of China, although indirectly related to Accounting system, was the introduction of the "Contract responsibility system" for large and medium-sized state-owned enterprises, that allowed managers and workers of the latter to retain and share profits when a surplus was generated (on which the company had to pay taxes first).

It was a first sign of autonomy of the managers and workers of these companies and represented an important step towards the realization of a shareholder system<sup>29</sup>.

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<sup>28</sup> Assets were classified according to their liquidity: current, immobilized, long-term investments, ongoing fixed assets, intangible assets and other assets. Liabilities were classified according to a criterion of realization, i.e.: current, long-term liabilities.

<sup>29</sup> The shareholding system assumed the existence of share capital enterprises (whose first experiments were in 1984) or companies similar to the western Ltd. companies, characterized by a separation between the company property and managers. At that time, these capital companies could be "internal share", where the company's capital was divided among the workers, or "public company" that placed the shares also to external subjects (type "a" if purchased only by Chinese investors and type "B" if purchased also by foreign investors, but the latter were introduced only after 1992). The first share-holding companies derived from "privatization" of SOEs, but, as indicated by Ball, R. et al., (2012), It was only partial: "the likelihood of China achieving the potential benefits of SOE listing was reduced by several compromises made during the implementation process. To prepare for listing, SOEs were organized into share-issuing companies and shares were sold to institutional and individual investors. However, a controlling share interest was retained by the state ". Ball and Robin (2012).

These novelties represent a real turning point in Chinese Accounting System and should be attributed to the will of Deng Xiaoping and the Ministry of Finance to stimulate the entrepreneurial initiative.

## **2.4 1984-1991: Planned Market Economy**

After five years of reforms, China had passed from a centralized planned economic system where all companies were state-owned to a mixed economic system where the control of the government and market forces co-operated to create the basis of the management of the companies whose ownership was shared between state and private entities. The private sector was developing very quickly and the business market began to take a leading role in the process of allocating available resources.

On the III Plenum of the XII Central Committee of the Chinese Communist Party, held in October 1984, was decided to abandon the old centralized planning system and to replace it with an economy in which the planning was only limited to the raw materials. However, the State property remained prevalent. Unfortunately, these measures did not lead to the expected results. At the macroeconomic level, the role of State planning in the management of the economy was substantially reduced. It was decided to introduce the concepts of mandatory plan and guide plan. The mandatory plan was concerned to a small number of particular raw materials and consumer goods, while most of the raw materials were included in the guide plan. The production targets defined for state-owned companies were substantially reduced to levels that would meet the minimum requirements of the State plan. Significant changes were made to the legislation about national trade and economic policies, to ensure a free flow of goods and products.

The foundations for the emergence of a national market were created.

In the late 1980s, the market had a more important role than the State plans in the process of allocating resources. The previous method of giving state funds to government-controlled companies was abolished and replaced by loans issued by the four banks<sup>30</sup> for specific sectors that operated under the supervision of the Chinese People's Bank.

State-owned companies were recognized as independent entities.

The Government therefore ceased to exert a direct administrative control, beginning to manage the approval of bank loans and the implementation of economic policies.

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<sup>30</sup> These are: Industrial and Commercial Bank of China; Agricultural Bank of China; China Construction Bank; Bank of China.

From a conceptual point of view, the State ceased to be involved in management activities, while remaining the economic entity able to impose its power over the companies.

The decision-making power on how to dispose of the means of production had been transferred to the companies. The control of the prices was eliminated and market forces soon replaced the state planning system in price fixing (Jackson, 1984).

One of the major changes (already mentioned in the previous paragraph) was the introduction of the contract responsibility system.

Based on this system, executives and employees had to sign a contract with the state that regulated certain activities such as planning, production, sales, and defined precise results. If the contractual terms were met, there was the possibility of retaining part of their profits to be used for the business expansion, the payment of production premiums or for the improvement of the well-being of the employees. If the contract was not satisfied, the companies were obliged to compensate the state with their own reserves.

The responsibilities of State-owned companies gradually increased over the period.

They were first transformed from production units to cost centres, where managers were encouraged to reduce production costs, while the State was managing price fixing and product distribution processes. Subsequently, following the delegation of decision-making and price liberalisation, State companies became profit centres where managers had the power to decide the price of the products, the purchase of materials, the production methods, the marketing strategies and the distribution process.

From this point on, the companies were forced to compete on the market and some of them could make some decisions about their investment plans.

However, the government retained control over many important financial decisions, relating to capital investment, salaries and wages. By the end of 1993, more than 90% of the state-owned companies were subjected to the contract responsibility system.

The changes at micro and macroeconomic levels, the lightening of the financial control system and the reform of the State-owned companies, led to the birth of two stock exchanges, in Shanghai and in Shenzhen. However, there was a lack of a legislative framework that regulates the development of companies and several problems emerged.

The increase of the complexity of commercial activities led to further modifications of the UASs in 1985 and 1989. Several changes were made.

The legislation that imposed the use of specific funds for specific purposes was abolished. Then, new items were represented in the balance sheet, for example, bank loans and corporate funds (non-distributed profits) that were replacing to government funds as

sources of financing for companies. Intangible assets, such as trademarks, patents and goodwill, began to appear in the balance sheet of joint ventures and other business combinations. A certain degree of flexibility was introduced in the UASs.

Bank loans, according to their specificity, have been subjected to a specific Accounting treatment. Bank loans from SOEs during this period were government funds that were received from companies through the banking system (the same funds that were previously given to companies without interests cost).

As part of the contract responsibility system and the new profit-sharing scheme, the reimbursement of bank loans was treated as a profit distribution after taxation, such practice generated confusion in doing accounts keeping (Huang and Chang, 1997).

The emergence of the Ltd companies created some specific Accounting problems.

For example, a company that belonged to entities operating in different industries would have been in difficulty regarding to the choice of which UASs to use for recording its accounts. These radical economic changes showed the need of a figure of certified public accountants. In 1986, the Council of State issued the regulations of the People's Republic of China on Certified Public Accountants, representing the first legal framework governing Accounting system, including admission exams to professional registers, academic and experience requirements, registration and professional conduct rules of certified public accountants. In 1988, the Chinese Institute of Certified Public Accountants (CIPCA) was established. Unlike its Western counterparts, the CIPCA is subject to the authority of the Ministry of Finance.



### **Chap 3. INTERNATIONALIZATION OF CHINESE ACCOUNTING SYSTEM: CONVERGENCE WITH IAS/IFRS**

#### **1992: Accounting System for Business Enterprises: OLD PRC GAAP**

The real transition to a shareholder system was concretely realized by the Government starting from the state-owned enterprises and Accounting in 1992, with the enactment in May of Accounting system for experimental enterprises with the shareholding system<sup>31</sup> and in November with the issuance of Accounting standards for business enterprises and financial guidelines for business enterprises.

From the point of view of financial reporting, thanks to the step back of the State from its central role as a single interlocutor and actor dealing with Chinese companies, for the first time in Chinese Accounting history, the balance sheet began to be used for external information functions. Accounting standards for business enterprises became effective since July 1993. The enactment of the ASBEs surpassed the Accounting fragmentation that had previously characterized the Chinese context.

In fact, the ASBEs became applicable to all companies regardless of their sector.

The general principles definitively and formally mark the shift from the fund-based Accounting system to the western one based on the concept of capital and income<sup>32</sup>.

Their content was divided into ten chapters and 66 articles.

The international pillars on which the Accounting reform was based, represented a great step towards the process of opening to foreign investors and markets.

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<sup>31</sup> The shareholding system implied the existence of share capital enterprises (whose first experiments back to 1984) or companies like the western companies shares-based, characterized by a separation between the company property and managers. At that time, these cases of capital companies could be of the type "internal share", where the company's capital was divided among the workers, or "public company", where the shares were sold also to external subjects (type "a" if purchased only by Chinese and type "B" if purchased also by foreign investors). The first share-holding companies derived from "privatization" of SOEs, but as indicated by Ball et al., (2012) It was only partial "the likelihood of China achieving the potential benefits of SOE listing was reduced by several compromising made during the implementation process. To prepare for listing, SOEs were organized into share-issuing companies and shares were sold to institutional and individual investors. However, a controlling share interest was retained by the state".

<sup>32</sup> At this stage, there were companies in China that used Western systems, such as joint ventures and those that continued to use Chinese procedures. Xiao and Pan (1997), Summarize in three points the objectives set at the basis of the enactment of the ASBEs: 1) Development of the socialist market economy; 2) Unification of the accounting system; 3) Quality assurance of accounting information.

These pillars were:

- 1) Accounting entity;
- 2) Going concern;
- 3) Accounting period or periodicity;
- 4) Monetary Measurement.

The ten chapters covered: General framework; General principles; Activities; Liabilities; Net capital; Revenues; Costs; Profit; Financial statements and further provisions.

In the first chapter, the general postulates of the standards were stated.

Article 1 defined their purpose at national level, which was to facilitate the development of the socialist market economy. In article 2 and in the following eight ones, there were general postulates such as: the applicability of the standards to all Chinese companies (art. 2), the currency of account and the language (art. 6 and art. 9) or the definition of the accounting year (art. 6) or the debit/credit system<sup>33</sup> (art. 8).

Other articles of a general nature were those relating to comparability (art. 12), consistency (art. 13) and historical cost (art. 19).

The second chapter also complied with general principles, such as: users of the financial statement (art. 11136)<sup>34</sup>: in this case the state was placed in first position, but following by the subjects around the company, as well as the company itself.

This article, which basically defines the stakeholders of the balance sheet information, represents an important novelty relating to the past.

While it contains the formal recognition of the existence of private interests "flanked" to those of the State, on the other hand, it is representative of the Chinese economic and political situation of those years, with the dominance of SOEs in the major industrial sectors and with a public authority aimed to defending the socialist regime from the

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<sup>33</sup> Lefebvre and Lin (1990), highlighted the areas of use of the increase-decrease and debit-credit methods: The debit-credit method was used in the manufacturing sector, the increase-decrease method in the trade and services sector, while the receipt-payment method in the agricultural sector or the government agencies. As also indicated by the scholars the last two methods were considered as "native Chinese inventions" as they were already used at the beginning of the Accounting practice in China. The introduction of the debit-credit method was therefore an important novelty of the 1992 reform, although it presented similarities with the increase-decrease method. Based on the work of Lefebvre and Lin the relationship between the two methods is as follows: "Increase" in fund application and expenses = Debit "decrease" in fund application and expenses = credit "increase" in fund sources and revenue = credit "decrease" in fund sources and revenue = Debit.

<sup>34</sup> Article 11 of the ASBEs said "the Accounting information must conform to the requirements of the state macroeconomic administration, meet the needs of interested parties in terms of understanding the financial situation and operational results of the enterprise and satisfy the demands from the enterprise itself for reinforcing internal management and control". The financial statement, according to this article complied with the information requirements of three types of subjects: 1) state; (2) Subjects interested in the economic and financial performance of the undertaking; 3) management of the enterprise. Chen and Tran (1995).

capitalist one. Other guiding principles contained in the second chapter of the ASBEs were related to: comparability (art. 12), Constancy (art. 13); Understandability (art. 15) and evaluation at the historical cost for activities (art. 19).

Closely linked to the principle of historical cost there is one of the most important principles introduced for the first time in the Chinese Accounting system: Accounting conservatism, indicated in art. 18 reciting "Accounting should calculate possible losses and expenses rationally according to the requirement of conservatism".

The Accounting conservatism represented the tendency to "anticipate no profit, but to provide for all losses" that in the European Accounting language can be translated with the concept of prudence. This field was the subject of analysis of the cultural studies in China as in the Maoist period this practice was pointed out as a means of expanding capitalism. (Hofstede and Harris, 1988); (Chow, et al. 1995); (Van Hoepen, 1995); (Graham and Li, 1997); Gao et al. 2003). The concept of conservatism, if culturally speaking represented one of the pillars of the philosophy of Confucius, in terms of Accounting lost consistency with the affirmation of communist ideology, that recognized the traits of capitalism (intended as an occult creation of value or reserves "stolen" from the community). The concept of conservatism Accounting had not formally existed before the reform, since in the centralised economic system, where the only actor was the state, there was no space to create uncertainty in the economic field, because the prices of the raw materials were also controlled by the state and the transactions were regulated primarily by cash. With the development of the market economy this situation has ceased. Mainly to encourage foreign investment, the Chinese Ministry of Finance allowed the recognition and devaluation of the receivables, by means of direct reversal, but only in a percentage fixed on the total value of the invoices issued and must be applied according to the principle of actuality; in other words, when the so-called "bad debt" has been discovered or proved (e.g. for the construction sector and agriculture, it was allowed in the 1% limit, while for enterprises in the energy sector of 2%).

In the third chapter, the composition of the activities was illustrated.

According to article 23, activities were classified as: current assets, long-term investments, fixed assets, intangible assets, deferred assets (receivables) and other activities.

The methodology for the economic valorisation of inventories was made at the historical cost, using either the LIFO or FIFO criterion (art. 28), while the valuation of investments (long-term investment) was still admitted at the historical cost criterion or at the equity method (art. 29).

The fixed assets had to be disclosed at the historical cost, net of the depreciation fund. The calculation of the annual depreciation was calculated through the application of the fixed quotas method, based on production obtained or accelerated only if approved (art. 30). Intangible assets had to be disclosed in the balance sheet at the cost of purchase or production and could be depreciated for the period of useful life attributable to the asset itself (art. 31). In chapter four, the concept of liabilities was illustrated.

The first classification was related to the unrealized liabilities, therefore there was a distinction between current and long-term liabilities (art. 35).

The concept of equity was faced in Chapter 5, as "The rights required by the investor in the Enterprise" and was composed of capital, reserves and profits/losses accumulated.

Chapters 6 and 7 were dedicated to revenues and costs, while chapter 8 regarded incomes.

The moment of revenues followed a discretionary logic, i.e. it was possible to consider alternatively the delivery of the goods or the service carried out, or at the time of billing or the delivery of the title of payment (art. 45). About costs, the definition and quantification of the cost of inclusive production of raw materials, labour force and other expenditure, such as sales and administrative expenditure (art. 48), was generally considered as a rule<sup>35</sup>. Given the focus on revenues and production costs, also for the determination of the profit of the company, the ASBEs defined the operating income, the income from investments and the result net of non-characteristic operations (NET no operational results-art. 54). The final articles related to the variation of the evaluation criteria, for which it was required to give a disclosure of the effects (as in a prospectus of reconciliation) and the consolidation of the financial statement that was compulsory only if the participation in another company was equal to or higher than 50%.

Chapter 9 finally defined the documents that companies had to draw up: balance sheet, income statement, financial statement or cash flow statement (art. 57).

In addition to the requirements contained in the ASBEs, share-based companies had to comply with the new company law, which became effective the following year (01 July 1994) of the introduction of the ASBEs. The new law prescribed the drafting of two additional documents to those referred to in article 57 of the Accounting standards, such as a note explaining the financial conditions of the enterprise and the scheme for allocating profits.

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<sup>35</sup> Gang argues that the choice to adopt this type of production cost "comprehensive" as a methodology for defining corporate costs was linked on the one hand to the need to simplify the calculations, on the other also to distinguish responsibilities in chief managers and then evaluate their performance. Gang, J., (1992).

Regarding the latter, the law said that companies should set aside a 10% of the retained profits annually, until the same amount reached 50% of the capital<sup>36</sup>.

In addition to Accounting standards for business enterprises, we also mentioned the enactment of the general financial principles for Enterprises in November 1992, which was effective from 01 July of the following year. The regulation had more operational ambitions than the ASBEs, that is to standardize the principles set out in the standards in order to make them applicable by the various companies.

The regulation was composed by 46 articles divided into twelve chapters: General provisions (Chapter 1), Raising funds (chapter 2) Financial management of assets, expenditure and profit (chapters 3-8), Foreign currency (Chapter 9), Liquidation of enterprises (chapter 10), Financial reports (Chapter 11) and supplementary provisions (chapter 12). Theoretically, Accounting standards should have had to introduce a substantial new conceptual framework for China, while the financial regulations brought some operational rules for corporate management.

Despite the intentions, this objective was not fully achieved because of an overlap between the legislation contained in the two documents and that we can define a natural consequence to the difficulty of bringing together a previously fragmented Accounting system (Liu and Turely, 1995). Following the issuance of the ASBEs there were two further steps in the development of the Chinese Accounting system: The first was the enactment by the Ministry of Finance of a series of specific (transitory) principles applicable to SOEs and the other was the launch of a three-years project for the elaboration of specific standards for each sector, so-called practical Accounting Standards (PASs) which began in February 1993 thanks to financial support from the World Bank. The latter was realized through the work of 4 task forces within the Accounting standard setting core group created within the Accounting Affairs Bureau (AAB) under the control of MOF. These were added to two groups with advisor functions, one formed by Chinese academics and accountants and the other by Deloitte Touche Tohmatsu International. The project ended in 1996 with the enactment of 30 standards applicable to all the economic sectors of China.

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<sup>36</sup> In addition to the prescription contained in the new company law there were also the regulations of the Security Regulatory Commission (SRC), which provided additional information. Companies within 120 days had to deposit to the SRC the annual reports whose content was also related to information about corporate governance and associated companies. Chow et al. (1995).

Exposure Draft of the Detailed Accounting Standards:

The First Batch (Exposure 1994):

- Balance Sheet
- Capitalization of borrowing costs
- Inventories
- Investments (revised later)
- Income statement
- Payables
- Receivables

The Second Batch (Spring 1995):

- Banking Industry
- Fixed Assets
- Intangible Assets
- Long-term construction contracts
- Owners 'equity
- Research and development
- Statement of cash flow

The Third Batch (Summer 1995):

- Accounting policies/estimates
- Consolidated financial statements
- Deferred charges
- Foreign exchange
- Income taxes
- Revenue recognition
- Subsequent events

The Fourth Batch (Autumn 1995):

- Contingencies and Commitments
- Donations and government grants
- Related party disclosures
- Employee benefits
- Reorganizations and liquidations

### The Fifth Batch (March 1996):

- Barter trade and other nonmonetary transactions
- Business combinations
- Futures contracts
- Insurance Industry
- Investments (including associates), revised
- Leases

Source: (Harris and Ray, 1996)

These principles, which differed from the ASBEs for having a more accurate content in operational terms, presented some dyscrasias compared to the postulates of the ASBEs; for example, the possibility to use for the assessment of inventories the lower amount between cost and market value or the application of the mark to market valuation for short-term investments (Xiang, 1998).

### ***3.1 Introduction of a new Conceptual Framework***

Before the economic reform, the Accounting system was entirely governed by the laws and regulations issued by the State Council (SC) and the Ministry of Finance.

These regulations were substantially developed by experts and promulgated by the Ministry of Finance without going through any legislative process.

The major novelty of the ASBEs was to introduce, in a highly fragmented Accounting system, as was the Chinese pre-reform, a common conceptual framework, which would serve as a "guide" for all companies, regardless of the sector.

The changes introduced by the policies of Deng Xiaoping and the will of China to "open the doors" to the West, led to an awareness of the inadequacy of the local Accounting language, comparing to the one used in most Western countries and therefore it should have been renewed. The need for adequacy was perceived as strongly impelling by the Chinese authorities. As seen in the previous chapter, the policy of "start from scratch" was privileged, with the issuance of the ASBEs, rather than modifying the Accounting system previously in use (UAS).

This was also the result of the government's choices to maintain the power of control, to facilitate the "acceptance" of the new system by stakeholders and to increase the international reliability of the Country (Xiao and Pan, 1997).

The conceptual framework introduced by the ASBEs has been defined in literature as "mixed", in other words, it was at the same time descriptive, prescriptive and constitutive<sup>37</sup>. It provided general statements (constitutive), drew on existing practices in both China and Western countries (descriptive) and was the result of decisions taken by the Government<sup>38</sup> and developed with special laws (prescriptive).

Analysing the contents of the conceptual framework and the differences with the one developed by the IASB, the first thing to be noted is that, despite the ASBEs for its content was assimilated to a conceptual framework, that word was not specifically mentioned within it<sup>39</sup>. Even though the contents of the ASBEs were partially borrowed from the one elaborated by the IASB (at the time still IASC), there were some significant differences. The main difference is the informational functions that Accounting standards disclosed. As we have already mentioned in the previous chapter in article 11), there is only one hierarchical listing of the subjects to whom the standards are directed.

The first is the State, for all the reasons have been exposed several times.

It is obvious that the main users of the Accounting information are neither the creditors nor the investors, but the State and the financial system (as a creditor) and lastly the management of the company. This approach was also in the following articles where the concepts of uniformity, comparability and consistency were treated (art. 12 and art. 13). This meant that "Accounting records and financial statements shall be prepared according to stipulated Accounting methods", which must be comparable and easily analysable and that the methods used cannot be arbitrarily changed (changes in the financial position and income, given by the change in the detection methodology, must be highlighted in the balance sheet notes). Another element of fundamental distinction between the ASBEs

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<sup>37</sup> Miller (1985) recognizes three different motivations underlying the establishment of a conceptual framework, reconnectable to three distinct "natures": 1)-descriptive nature: to describe existing practice, i.e. coding and description of existing practices; 2) – Prescriptive nature: to prescribe future practice, that is to provide specific guidelines on how companies should operate; 3) – Constitutive nature: To define key terms and fundamental issues, that is to say some basic principles that companies should follow..

<sup>38</sup> Xiao and Pang (1997) showed how in China the conceptual framework Development path had been of institutional type, since the MOF performed both regulator and standard setter body functions. The authors see in this approach a similarity with Germany, Japan and France, countries characterized by a strong influence of the state in the development of their accounting systems. However, the choice made by MOF to adopt a conceptual framework borrowed in large part by the IASB, that is afferent to the so-called Anglo-Saxon model is opposed to this consideration. The authors justify this dualism in the will (or convenience) of China to adopt a system that was easier and more accepted in the rest of the world.

<sup>39</sup> "The term "Conceptual framework" is not explicitly stated in China's "Accounting standard". Although many of the essential components of the conceptual framework are contained in the "Accounting Standards" (such as a statement of objectives, qualitative characteristics, assumptions, elements of financial statements and the concept of capital maintenance), others are not explicitly stated and must be inferred from other sources. The "Accounting Standards" generally follow the Anglo-American model of accounting. Many parts of the "Accounting Standards" are similar to the formalized conceptual frameworks of the IASC, Canada and the U.S.". Davidson et al. (1996).



framework and the IASB one is the postulate of the "substance above the form" which in the ASBEs is not mentioned neither directly nor indirectly.

This difference, attributable to the rule-based nature of Accounting standards is obvious if one thinks that the main user of the information is the State and its purpose is the economic control. To meet this need, ASBEs is more prescriptive and binding than the IASB's conceptual framework. A proof of the previous statement is the scarcity of freedom of judgement that companies have under the ASBEs, which are only related to the assessment of inventories, the choice of the Accounting year and the definition of production cost. Another important differentiation is attributed to the valuation method that in the ASBEs follows the criterion of the historical cost and not the market one.

This aspect is also related to the absence of a free market with the consequent impossibility of having a "real" value of the asset being evaluated.

In addition to these differences, the most important one should be added, also highlighted in several researches on this matter, that is the lack of orientation towards the "conservative (or prudence) Accounting". This difference has also been empirically found by the researches conducted on the companies issuing both the types of shares (A-shares and B shares) that have shown an overstatement of income and assets by applying Chinese GAAP compared to the application of IFRS (Lin and Chen, 1999); (Ball et al. 2000); (Sun et al. 2005); (Liu and Zhou, 2007); (Wei and Tao, 2007).

The main reasons that can be deduced are not only attributable to the rules-based model that has already been mentioned, but also to the tax-oriented model applied in China.

In fact, we must not forget that the Ministry of Finance (MOF) is also the standard setting body. It is therefore obvious that the concept of prudence and conservatism, having an impact on the tax assessment of companies and resulting in a reduction of revenue got by the state was not, at least at that the time, of primary interest.

The following (Tab.1) is a comparison table between the conceptual frameworks based on Accounting standards for Business enterprises (ASBEs) and the one based on IASB (at the time still IASC).

Tab.1

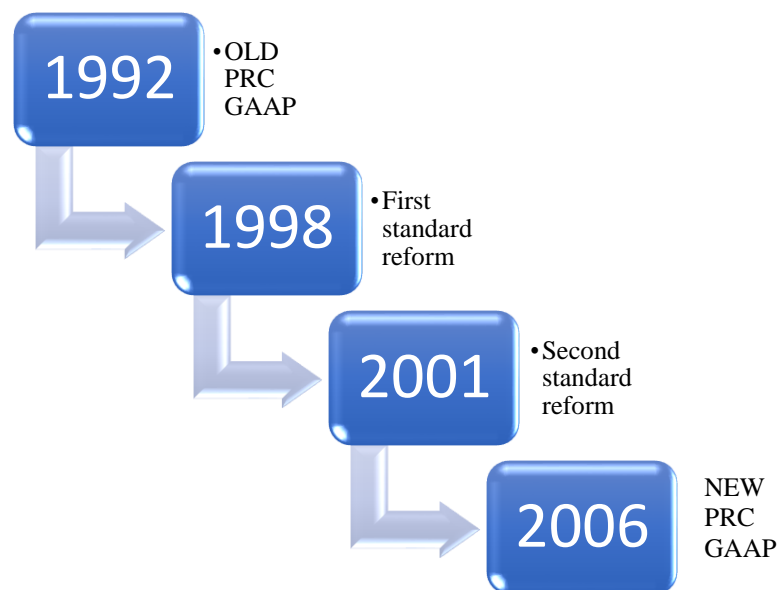
TOPIC	ASBE	IASB
Mixture of frame work and standards: yes/no	Yes	No
Prime user group: a) investors and creditors b) investors c) government and management d) not specified	C	D
User information needs (differences acknowledged): yes/no	No	Yes
Objectives: a) decision usefulness b) stewardship c) unclear	C	A&B
Prime qualitative characteristics: a) understandability b) relevance c) reliability d) comparability e) objectivity	E	A&D
Qualitative characteristics (the way they are weighted): a) hierarchically layered b) sequentially listed	B	A
Qualitative characteristics (trade-offs acknowledged): yes/no	No	Yes
Qualitative characteristics (cost as constraint recognized): yes/no	No	Yes
Qualitative characteristics (operational definition provided): yes/no	No	Yes
Recognition and measurement (approach): a) asset and liability view b) revenue and expense view	B	A
Measurement (bases): a) historical cost b) value to the business c) no preference	A	C
Capital maintenance: a) various concepts discussed b) no concept discussed c) current practice described	B	A

Source: Xiao et al. (1995).

Despite these differences between the conceptual framework of Accounting standards for business enterprises and the international IAS/IFRS principles, the innovative scope of the ASBEs and the effort made by the Ministry of Finance towards Accounting harmonization were undoubted, as well as the positive effects on the intelligibility of Chinese financial statements, that was evident. The surveys that have been conducted in those years (but also later) confirm these progresses achieved (Lin et al. 2001); (Nie et al. 2013). Although the positive feedback on the introduction of the new Accounting system, the Chinese Ministry of Finance, aware of the still existing differences and with a will to continuing the internationalization of its economy, has kept reforming Accounting standards for business enterprises, proceeding to revisions in 1998, 2001 and finally in 2006, when the ASBEs have obtained the recognition of a substantial convergence by the IASB.

### **The harmonization process of PRC GAAP towards a convergence with IFRS**

Graphic N°2



Source: elaborated by the author

### 3.2 The reform of 1998

In the previous paragraph, the peculiarities of ASBEs were illustrated in comparison to the conceptual framework developed by the IASB, based on International Accounting standards. It was said that, despite the innovations of the reform, there were some substantial differences between the two aforementioned conceptual frameworks.

These differences were analysed in the literature (Chen et al. 1999), (Lin and Wang, 2001); (Chen et al. 2002) with reference to the companies issuing B-shares, which was obliged to draw up their financial statement also following the IAS/IFRS principles, according to the legislation introduced in 1992 “Accounting regulation for experimental listed companies”. These researches have shown a substantial negative difference between the profits of the companies drawn up according to the ASBEs compared to what is achievable according to IAS<sup>40</sup>. In order to eliminate the discrepancies still existing between the PRC GAAP and IFRS principles, the Ministry of Finance proposed a new reform in 1998 (new Accounting regulation for listed companies), through which the Chinese Accounting practices for listed companies would be harmonized with the requirements of international Accounting standards, also decreasing gaps, particularly on the profits, recognised by the aforementioned research.

The following table (Tab.2), summarizes and compares to the IAS/IFRS seven Accounting methodologies related to the Chinese regulation of 1992 and 1998.

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<sup>40</sup> Chen, J.P.C., Gul, F.A., Su, X., analysed the financial statement of the B-shares companies listed on the Shanghai market for the period 1994-1997. The research has shown in the whole sample a substantial difference in the profits found according to the Chinese principles compared to the restatement according to IAS principles. In some cases, a passage from profit to loss was also highlighted.

Tab.2

Method	1992 Regulation	1998 regulation	IAS/IFRS
Provision of risk fund on receivables	Established by the Government with % variables between 0.3%-0.5%	Established by the Company	Established by the Company
Valuation of Inventories	Historical cost	The lower between the purchase cost and the realization value	The lower between the purchase cost and the realization value
Investments valuation	Historical cost for both fixed and current investments	The lower between purchase cost and market value	The same, but with the possibility of making revaluations to increase in equity (reserve)
Valuation of equity investments	Equity method if investments exceed 50%	Equity method if investments are between 20-50%	Equal
Plant costs	Depreciable over 5 years	Can be amortized up to 5 years	Can be amortized up to 20 years, but commonly up to 5 years
Revenue recognition	At the time of shipment and payment (or payment promise) of the goods	At the time of the transfer of the risk, advantages and control connected to the goods, payment received and the cost is measurable	Equal
Consolidation Area	When the company owns more than 50%	When the company owns more than 50% including joint ventures	Equal

Source: Chen, S. et al. (2002)

Regarding this further step towards the harmonization with International Accounting Standards, must be noted that the will of Chinese Ministry of Finance to increase the international credibility of its economy has emerged.

However, it was still an early stage and this is demonstrated by the research that has been conducted on the financial statements of Chinese companies at that time, which still showed large discrepancies in terms of the determination of incomes between Chinese

companies applying the Chinese principles (issuers of "A"-type shares) and those applying the international principles (also or only issuing "B"-type shares)<sup>41</sup>.

The effect generated by the restatement with the IAS/IFRS principles has also been analysed in terms of value relevance highlighting the low incremental value in informational terms for investors (Bao and Chow, 1999); (Chen et al. 2001); (Lin and Chen, 2005). Among the 10 standards issued during 1997-2000, three required the use of fair value measurement: Debt Restructuring (1999), Non-monetary Transactions (1999), and Investments (2000). The initial adoption of fair value measurement was perceived as a natural stage in China's economic development. The creation of Chinese stock exchanges in the early 1990s and the rapid development of Chinese listed firms and capital markets, as well as the fast-growing economy, represented a great chance to renew the old Accounting system related to historical cost. Many obsolete inventories, uncollectible receivables and overvalued investments were still on the books, while huge unrealized investment gains were unreported.

In the same period, the use of fair value-related attributes in financial reporting gained increasing support from leading standard setters (FASB and IASB, for example), major market regulators (SEC, etc.), and Accounting academia (Barth, 1994, etc.).

The Chinese Ministry of Finance, aware of the problems of historical-cost-based reporting in the existing economy and the new trend of using fair value in international financial reporting, started its first fair value reform (Peng and Bewley, 2010).

Empirical research has shown a marginal utility of the 1998 reform in terms of compliance of financial statement with IFRS principles.

Certainly, the major novelty was the introduction of the use of fair value for the valuation of assets and liabilities, criterion that will be removed with the subsequent update of the ASBEs of 2001.

### **3.3 The reform of 2001**

Thanks to the funds allocated by the World Bank in 1999 (Accounting Reform and Development Project), the Chinese Ministry of Finance intervened again on Accounting system for business enterprises with a new reform, effective from 01 January 2001.

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<sup>41</sup> Chen et al. (2002): Despite the high expectations of the reform, the gap between earnings recognition according to Chinese principles and IAS/IFRS had not significantly decreased. The authors analysed the financial statements of 75 companies for a period of three years (1997-1999), finding that the profit according to Chinese accounting standards fell from 80% in 1997 to 69.34% in 1999.

The substantive differences from the 1998 reform relate to the assessment of inventories, receivables, investments and tangible fixed assets (see Tab. 3).

Tab.3

Item	1998	2001	IAS/IFRS
Inventory valuation	Historical cost or the lower between the cost and the realization value (LCM)	LCM	LCM
Short-term investment assessment	Historical cost or the lower between the cost and the realization value (LCM)	LCM	Fair value
Bad debt	% approved by MOF (0.3 – 0.5) or determined by the company	Determined by the company	Determined by the company
Ongoing construction	Amortized cost	Amortized cost and impairment test	Amortized cost and impairment or fair value
PPE evaluation	Amortized cost	Amortized cost and impairment test	Amortized cost and impairment or fair value
Valuation of intangible assets	Amortized cost	Amortized cost and impairment test	Amortized cost and impairment or fair value
Real estate	Amortized cost	Amortized cost and impairment test	Amortized cost and impairment or fair value
Plant costs	Can be amortized up to 5 years	Capitalized until the start of the activity and subsequently considered as costs	Considered as costs

Source: Peng et al. (2008).

LCM= Lower of cost or market.

Research carried out over those years has shown an evident increase in comparability between Chinese GAAP and IFRS International accounting standards compared to the 1998 standard<sup>42</sup> (Peng et al. 2008); (Foo et al. 2009); (Kuan and Noronha, 2007); (Chen and Zhang, 2010). Despite this positive feedback, the Chinese Ministry of Finance has made a step forward in the process of harmonization, but also a step back with the prohibition of the use of fair value in the 2001 reform.

In this context, the prohibition of fair value use, after the first introduction by the 1998 reform, should be red in consideration that in an imperfect or immature market it is difficult to establish the real market value of an asset (Xiao et al. 2004).

Moreover, the demand for Accounting information was not yet enough developed at the time of the first introduction. The 1998 reform's purpose was to move toward IFRS, but it was stopped by a series of scandals related to firms taking advantage of fair value standards immediately after their release. It was reported that about two-thirds of China's largest state-owned enterprises (SOE) had falsified their 2000 financial statements, with the total amount exceeding 100 billion Yuan [equivalent to 12.5 billion US dollars].

The abuse of fair value rules was suspected of having allowed firms to manipulate profits and transfer proceeds to majority shareholders, who are often politically-connected to administrative supervisors in Chinese companies.

These abuses forced Chinese Ministry of Finance (MOF) to revise the three fair-value-related standards issued in 2001, abolishing this kind of assets and liabilities measurement. Fair value accounting regulation started with good intentions but had a disappointing outcome. As a result of the 2001 reform, the companies issuing "A" type shares, that are purchasable only by Chinese investors, continued to apply local GAAP, while companies issuing (also or only) shares of type "B", that are also available to foreign investors, had to draw up their own financial statements also according to IFRS International Accounting standards. Therefore, companies issuing shares of both types, were required to draw up two financial statements, one according to the Chinese principles and one according to IAS/IFRS (Peng and Bewley, 2001).

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<sup>42</sup> The study conducted by Chen and Zhang highlighted empirically how harmonization through the use of standard principles did not directly lead to the harmonization of Accounting practices. The authors have identified a strong link, in achieving the comparability given with the corporate governance of the company, seen as a method of application of the standards (eg: opportunistic behaviour of managers but also the non-perfect understanding of the principle of IFRS to apply). In this sense, the authors believe that a fundamental role is given by the auditing activity that monitors the application of the principles by companies and also contributes to the harmonization of the accounting practice. Chen and Zhang (2010).



Although the reason for this further reform of Chinese Accounting standards was mainly linked to China's will to become part of the WTO (World Trade Organization), fact that occurred in 2001, however, as indicated in above research, has also helped in harmonizing Chinese GAAP with IFRS, affecting positively the comparability of financial statements. The only drawback that was made in the convergence path, was the application of the fair value method, which, as indicated, after a first introduction in 1998, will be banned and will remain in stand-by until the next reform in 2006.

### **3.4 The reform of 2006: Accounting Standards for Business Enterprises (ASBE): NEW PRC GAAP**

The 2006 reform represented the last phase of the process of Accounting harmonisation routed by China. This fourth step was officialised in February 2006 with the introduction of 22 new standards (CAS) and the revision of the existing 16, came to effect on 01/01/2007. The Chinese minister of finance of that time, 金人庆 (Jin Renqing), in a speech dedicated to the reform of the ASBEs, defined it as a concrete expression of a policy of "bringing in, going out", that meant the possibility offered to foreigners to better understand the Chinese principles, but also the possibility for Chinese companies to better understand the financial statements of foreign companies (Wang and Hou, 2012).

Given the importance attributed to the reform by the Chinese Ministry of Finance in terms of convergence with IFRS, an "awareness raising" programme was initiated, addressed to companies, Accounting agencies and to the academic community, aiming to educate the interested parties about the new principles and bridging the cultural and experience gaps towards IFRS principles. The training project involved the main national Accounting Institutes (NAIS), the Institute of Certified Public Accountants (CICPA) and the China Securities Regulatory Commission (CSCR). In addition to this internal campaign, in order to give greater international emphasis to the reform, the CASC (China Accounting Standards Committee) and the IASB signed in November 2005 a memorandum confirming the substantial convergence with the IFRS principles with the exception of three points: financial reporting on transactions with related parties, valuation at fair value and business combinations (exclusion of SOEs from the concept of business aggregation). At the international level, the first standard setter to recognize the equivalence of its principles with those Chinese was the Hong Kong Institute of CPAs.

In Europe, indeed, following the memorandum with the IASB in 2005, the European Commission in 2007 with regulation 1569<sup>43</sup> defined the conditions under which the Accounting standards of a non-EU country could be considered equivalent for a transitional period of three years. In March 2008, the CESR (Committee of the European Securities Regulators<sup>44</sup>) pointed as the beneficiaries of this transitory equivalence China, Canada, India and South Korea, considering their principles substantially equivalent to IFRS until 31 December 2011.

The list of new and revised ASBEs principles is given in the following table:

Tab.4

N°	ASBE basic standards	New/Revised
1	Inventories	R
2	Long term equity investments	R
3	Investment property	N
4	Fixed assets	R
5	Biological assets	N
6	Intangible assets	R
7	Exchange of non-monetary assets	R
8	Impairment of assets	N
9	Employee compensation	N
10	Enterprise annuity fund	N
11	Share-based payment	N
12	Debt restructurings	R
13	Contingencies	R
14	Revenue	R
15	Construction contracts	R
16	Government grants	N
17	Borrowing costs	R
18	Income taxes	N
19	Foreign currency translation	N
20	Business combinations	N
21	Leases	R
22	Recognition and measurement of financial issue	N
23	Transfer of financial assets	N

<sup>43</sup> Commission regulation establishing a mechanism for the determination of equivalence of accounting standards applied by third country issuers of securities pursuant to Directive 2003/71/EC and 2004/109/EC of the European Parliament and of the Council.

<sup>44</sup> The CESR since 2011 has changed in the European Securities and Markets Authority (ESMA)

24	Hedging	N
25	Direct insurance contracts	N
26	Re-insurance contracts	N
27	Extraction of petroleum and natural gas	N
28	Changes in accounting policies and estimates and correction of errors	R
29	Events after the balance sheet date	R
30	Presentation of financial statements	N
31	Cash flow statements	R
32	Interim financial reporting	R
33	Consolidated financial statements	N
34	Earnings per share	N
35	Segment reporting	N
36	Related party disclosures	R
37	Presentation of financial instruments	N
38	First time adoption ASBE	N

Source: Heng and Norohna (2011).

The new PRC GAAP are also formed by:

-Application guidance, a kind of operational guide that clarifies the contents of specific standards, provides additional information on complicated but essential key issues and includes instructions on the form of the balance sheet, on the chart of accounts, on notes to the financial statement, etc.;

-China Accounting Standards (CAS) bulletins and other complementary rules, which relate mainly to issues identified in the implementation of the new Chinese Accounting principles or also respond to certain requirements required in IAS/IFRS, providing rules facilitating convergence;

-The interpretation guidance of CAs, published by the Accounting Regulatory Department of the Ministry of Finance, offer detailed explanations and specific and complete examples concerning the requirements required by the standards. They also cover some improvements and changes that facilitate convergence with IAS/IFRS.

The ASBEs regulate almost all the Accounting areas governed by the existing international Financial Reporting Standards (IAS/IFRS) and their observance by the listed

Chinese companies is compulsory since January 1, 2007 with the intention of making them apply to all other companies. During the preparation of the ASBEs<sup>45</sup>, the Chinese Ministry of Finance highlighted some areas in which they could make a significant contribution to the objective of the International Accounting Standards Board (IASB) to develop highly qualitative solutions for IFRSs. Among the areas identified, there are the information on transactions between related companies (e.g. state-owned companies), aggregations of companies controlled by the same subject and determinations of fair value. These ASBEs were not only used to broaden their information requirements, but have made substantial changes to the general Accounting practice of mainland China. Consequently, their application had significant results also on the determination of the operating results, the value of net assets and the reporting obligations.

The main studies that have affected the ASBEs 2007 and its effects in general terms agree on an improvement in the quality of the financial reporting, the transparency and correctness of the information introduced in the Chinese Accounting system.

The research of Wang et al. (2012) has shown an increase in numerical terms of foreign financial analysts operating on Chinese companies (as evidence of a growing interest in this country at the financial level) and a reduction in terms of financial forecasts on Chinese stocks. Heng and Noronha (2010), have noted the presence of substantial differences in the determination of the operating results, according to the two types of GAAP (i.e. pre-and post-reform) of Chinese companies issuing A-shares in the markets of Shanghai and Shenzhen. The difference according to the authors is attributable in large part to the use of fair value, reintroduced precisely with the reform of 2006.

Peng and Van der Laan Smith, that have dealt with the level of convergence of Chinese GAAP with IAS/IFRS, analysing 159 items related to the four steps of the reform (1992-2006). The study showed a substantial increase from 1992 to 2006 from 20% to 77%.

The direct or close correlation with IAS/IFRS is also highlighted in the following table where the two sets of standards have been associated (NEW PRC and IFRS/IAS):

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<sup>45</sup> As is highlighted in the joint statement by the Chinese Accounting Standards Committee (CASC) and the President of the International Accounting Standards Board (IASB) on 8 November 2005.

Tab.5

IFRS 1	First-time adoption of international Financial reporting standards	CAS 38	First adoption of accounting standards for business enterprises
IFRS 2	Share-based payments	CAS11	Share-based payments
IFRS 3	Business combinations	CAS 20	Business combinations
IFRS 4	Insurance contracts	CAS 25 CAS 26	Direct Insurance Contracts Reinsurance contracts
IFRS 5	Non-current assets held for sale and ceased		See note 1
IFRS 6	Exploration for and evaluation of mining resources	CAS 27	Extraction of Oil and natural gas
IFRS 7	Financial instruments: Disclosures	CAS 37	Financial instruments: Presentation and disclosure
IFRS 8	Operating Segments	CAS 35	Segment Reporting
IFRS 10	Consolidated financial Statements	CAS 33	Consolidated financial Statements
IAS 1	Presentation of Financial Statement	CAS 30	Presentation of Financial Statement
IAS 2	Inventories	CAS 1	Inventories
IAS 7	Statement of Cash Flows	CAS 31	Statement of Cash Flows
IAS 8	Accounting policies, changes in Accounting and estimates and errors	CAS 28	Changes in accounting standards and Accounting estimates and correction of errors

IAS 10	Events after the reporting period	CAS 29	Events after the Balance Sheet date
IAS 11	Construction Contracts	CAS 15	Construction Contracts
IAS 12	Income taxes	CAS 18	Income taxes
IAS 16	Property, Plant and Equipment	CAS 4	Fixed Assets
IAS 17	Leases	CAS 21	Leases
IAS 18	Revenue	CAS 14	Revenue
IAS 19	Employee Benefits	CAS 9	Employee Benefits
IAS 20	Accounting for Government Grants and Disclosure of Government Assistance	CAS 16	Government Grants
IAS 21	The Effects of Changes in Foreign Exchange Rates	CAS 19	Foreign Currency Translation
IAS 23	Borrowing Costs	CAS 17	Borrowing Costs
IAS 24	Related Party Disclosure	CAS 36	Related Party Disclosure
IAS 26	Accounting and Reporting by Retirement Benefit Plans	CAS 10	Enterprise Pension Funds
IAS 27 IAS 28	Separate Financial Statements Investments in Associates and Joint Ventures	CAS 2	Long-term Equity Investments
IAS 29	Financial Reporting in Hyperinflationary Economies		See note 2
IAS 32	Financial Instruments: Presentation	CAS 37	Financial Instruments: Presentation and Disclosure
IAS 33	Earnings per Share	CAS 34	Earnings per Share
IAS 34	Interim Financial Reporting	CAS 32	Interim Financial Reporting
IAS 36	Impairment of Assets	CAS 8	Impairment of Assets

IAS 37	Provisions, Contingent Liabilities and Contingent Assets	CAS 13	Contingencies
IAS 38	Intangible Assets	CAS 6	Intangible Assets
IAS 39	Financial Instruments: Recognition and Measurement	CAS 12 CAS 22 CAS 23 CAS 24	Debt Restructurings Financial Instrument: Recognition and Measurement Transfer of Financial Assets Hedging
IAS 40	Investment Property	CAS 3	Investment
IAS 41	Agriculture	CAS 5	Biological Assets
See note 3		CAS 7	Exchange of Non-Monetary Assets

Source: KPMG, 2014.

**Note 1:** There is no specific standard about non-current assets held for sale and discontinued operations under New PRC GAAP. However, corresponding requirements can be found in the following New PRC GAAP pronouncements:

Tab.6

Regulation	Relevant guidance
CAS 4—Fixed Assets	Requiring that the carrying amount shall be adjusted if the fixed asset is held for sale.
CAS Bulletin No. 1	Prescribing that the accounting treatment for other non-current assets held for sale should be the same as that for fixed assets held for sale.
CAS 2—Long-term Equity Investments	Prescribing that the accounting treatment for long-term equity investments held for sale should be the same as that for fixed assets held for sale.
CAS 30— Presentation of Financial Statements	Requiring that non-current assets held for sale should be classified as current assets and presented separately in the balance sheet. Prescribing the definition of “discontinued operations” and the related disclosure requirements.

Source: KPMG, “An Overview of New PRC GAAP, 3<sup>rd</sup> edition, October 2014.

**Note 2:** There is no specific standard on financial reporting in hyperinflationary economies under New PRC GAAP. However, CAS 19—Foreign Currency Translation and its application guidance prescribe the fundamental characteristics of hyperinflation, and how to restate and translate the financial statements of a foreign operation that operates in a hyperinflationary economy.

**Note 3:** There is no specific standard under IFRS on exchanges of non-monetary assets. However, the accounting treatments for exchanges of non-monetary assets that are set out in CAS 7—Exchange of Non-Monetary Assets are similar to those found in IFRS, for example, in IAS 18—Revenue and IAS 16—Property, Plant and Equipment.

Some studies have focused on the application of fair value in China, studying the evolution, the pros and cons (Liu, 2010); (Peng and Bewely, 2010); (Zhang et al. 2010); (He et al. 2012).

In terms of Accounting harmonisation, the introduction of valuation techniques made at market value are certainly a real "leap forward" for China.

The fair value in fact had three phases in Chinese Accounting evolution: the first introduction with the ASBEs of 1998, a second restriction (following the misuse of the instrument with consequent manipulation of the evaluations by many Chinese companies) and a third of re-introduction with the ASBEs 2006.

The reintroduction of the fair value in the ASBEs 2006 version represents a further and important step forward made by MOF not only towards harmonization with the IFRS principles, but also to the greater accreditation of its principles at the international level. The immaturity of stock markets but also the poor Accounting culture in the first phase of the fair value (1998) have created distortions in the use of the valuation instrument at market value. By issuing a 2007 ASBEs, the standard setters appear to have understood the appropriateness of fair value use in Chinese financial reporting.

Some factors have driven this decision. First, Chinese Ministry of Finance soon realized that simply forbidding fair value use is not a quick solution to fraudulent reporting, because the reasons the frauds occurred are rooted in China's social economic context.

Firms can continue fraudulent reporting regardless of the Accounting standards by applying more creative approaches. China's 2001 annual reports revealed a continuing flood of firms that incorrectly used Accounting standards. An official investigation of the 2001 annual reports of 192 firms in China found that more than 50% misreported profits and 103 had inaccurately reported their profits by more than 10%, (Far East Economic Review, 2003).



These statistics indicate that in 2001, many listed firms were still manipulating financial statements by engaging in creative transactions that complied with Accounting regulations only in appearance. Fair value adoption was a logical consequence of China's rapid economic development. By 2006, the number of firms listed in China had grown from 14 in 1992 to more than 1,400, and market capitalization increased to 8,940 billion Chinese Yuan (equivalent to USD \$1,120 billion), placing China in the third position in Asia and the tenth position worldwide (Peng and Bewley, 2010).

The explosion of financial products, especially derivatives, has challenged the legitimacy of historical cost. Historical cost is transaction-based, but derivatives by nature exist before transactions occur. Thus, in the traditional historical based Accounting system, a derivative's value is not captured in financial reports until its settlement date.

Meanwhile, the fast-growing capital markets led to expanding financial and insurance markets and emerging incentive share plans. Fair value measurements are believed to be superior to historical costs in these areas. The re-proposing, at the distance of eight years, of the use of fair value has enabled the infrastructures and the companies to develop adequately and also to bring to the local financial users and prepares budgetary information more adherent to the market reality.

### ***3.4.2 A comparison with OLD PRC GAAP***

When businesses moved from the old to the new PRC GAAP, a key priority was to identify the differences that exist between the two set of standards.

A reasonable starting point could be to compare the internal Accounting standards and the individual procedures already existing, adopted according to the old PRC GAAP, in comparison to the new PRC GAAP, as this will lead to focus only on those differences that are deemed relevant to the enterprise and help to identify these differences in a sufficiently detailed manner in order to determine the potential impact on their financial reporting systems. The new PRC GAAP tend to be more principle based than the old PRC GAAP and include implementation guidance which, in order to be applied, requires technical and specialized personnel in the Financial and Accounting fields, so that specific opinions can be provided. For example, the old PRC GAAP, when an exchange of non-monetary assets (fixed assets, investments, inventories) occurred, the costs of the goods received were measured based on the carrying amount of the assets transferred.

On the other hand, the new PRC GAAP states that the measurement base must be the fair value or the carrying amount depending on whether the trading transaction has a commercial substance and whether the fair value is deemed to be reliable.

Furthermore, as mentioned in the above paragraph, the new PRC GAAP aim to increase the use of fair value. The old PRC GAAP generally adopted the historical cost method as a measure principle. The new PRC GAAP introduced further requirements for fair value, which is defined as "the amount at which an asset may be exchanged, or a liability may be settled, between aware and available parties, in a transaction between independent third parties", as provided by IAS/IFRS. For example, in a business combination where companies are not involved under common control, the cost paid by the purchaser must include all the current values at the date of acquisition and the transferred assets and liabilities incurred or assumed, in order to obtain the control of the acquired party.

Compared to the old PRC GAAP, the new PRC GAAP also contain additional information obligations to align themselves more and more to IAS/IFRS.

An informative risk and sensitivity analysis, in fact, in relation to financial instruments is nowadays fundamental, as well as the methods used to determine the fair value to which transactions and events are commensurate. These reporting obligations may represent important challenges for the financial sector staff, who will have to adapt the information to reflect the company's facts and circumstances.

Finally, the new PRC GAAP were developed with the intent to achieve convergence with IAS/IFRS. This correlation was recognised, as mentioned above, by the IASB in November 2005.

### ***3.4.3 A comparison with IAS/IFRS***

As discussed earlier, although the new PRC GAAP converged with IAS/IFRS, it cannot be assumed that the policies adopted by the latter will comply with the new PRC GAAP in all cases. Moreover, the financial information disclosed according to the new PRC GAAP do not match always the IFRS ones, particularly in the case of consolidated financial statements. The following situations may occur:

Some options that are allowed according to IAS/IFRS, are not in the new PRC GAAP.

New PRC GAAP contain specific obligations for some of the problems commonly found in China, where IAS/IFRS do not have regulations. Some specific needs contained in

IAS/IFRS, about issues not commonly found in China, are covered by general principles in new PRC GAAP, rather than being included in specific standards.

It may take some time between the adoption of the IAS/IFRS principles and the adoption/adaptation of the respective new PRC GAAP, particularly when the use of an IAS/IFRS principle can be adopted before its effective date.

Therefore, some Accounting treatments that must be adopted according to the new PRC GAAP, may not be the only option granted by IAS/IFRS. This results in the possibility that policies adopted based on IAS/IFRS may be unacceptable according to the new PRC GAAP or, vice versa, policies adopted in the new PRC GAAP may be incompatible with those chosen in other parts of the group to which the Foreign Investment Enterprise belongs. In order to improve the comparability of the different companies' financial reporting, the NEW PRC GAAP reduce the possibility of adopting different models of evaluation compared to those possible and expected according to IAS/IFRS (Heng and Noronha, 2011). For example, according to IAS/IFRS, both the model of the cost and the model of the value revaluation are allowed in the case of elements belonging to the property, the equipment and the machinery for the company. The new PRC GAAP only accept the cost model. In this case, if the foreign company uses the model of the value revaluation according to IAS/IFRS, there may be differences between the financial reporting of the FIE drawn up according to the NEW PRC GAAP and the consolidated financial statements to which the FIE adheres.

As considered by the Ministry of Finance at the drafting time of the new PRC GAAP, there are some social and economic issues that are commonly found in China but on which IAS/IFRS have no regulations. For example, in the case of business combination involving companies under common control, the new PRC GAAP clarifies that only a method of Accounting similar to the pooling of interest method<sup>46</sup> is acceptable.

According to IAS/IFRS, the purchase method can be adopted, which states that the Accounting must take place at current value. The acquirer should calculate the assets and liabilities at the respective fair value at the date of acquisition and any positive difference between the acquisition price and the fair value of net assets constitutes goodwill.

The latter, rather than being systematically depreciated, is periodically tested by the impairment test to evaluate the possible reduction in value.

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<sup>46</sup> The pooling of interests' method consists in the transposition of the historical accounting values of the aggregated company, thus ensuring continuity in the accounting values. In fact, with this methodology, the company acquires the assets, liabilities, balances of equity accounts as resulting in the closing balance of the acquired party.

Therefore, as has already cited in the examples, that different valuation methodologies will lead to the presence of differences in the financial statements of companies respectively drafted according to the new PRC GAAP and according to the International accounting standards. As the IAS/IFRS, also the new PRC GAAP do not include some of the specific provisions of the International Accounting standards for transactions not commonly found in the Chinese territory. An example is the share-based payment plans. According to the new PRC GAAP the stock-based payment options are allowed in relation to the provision of services, similar to those dealt with IFRS 2, but the new PRC GAAP do not contain a specific principle regarding the Accounting treatment of that transaction, because in the People's Republic of China this type of remuneration is very rare. In cases where the foreign investment enterprise applied the Accounting principles used by the group to which it belongs, the new PRC GAAP generally do not allow companies to directly adopt the IFRS linked to specific issues not included in the PRC GAAP. The companies should not follow the group directives when Chinese Accounting standards do not provide regulations. The companies should assess the extent of the differences between the adoption of the two different Accounting principles and, if necessary, should contact the Ministry of Finance, trying to understand whether the Accounting treatment adopted is allowed or not before acting. The only exception to the above requirement, which is clearly permitted by the new PRC GAAP, is related to a Chinese parent company in the preparation of the consolidated financial statements.

When a foreign subsidiary incurs in a transaction that does not exist or is prohibited by Chinese laws or regulations, or that occurs in rare cases and is therefore not addressed within a specific standard of the new PRC GAAP, the parent company may combine the amounts originally accounted by the subsidiary abroad in accordance with IAS/IFRS in the consolidated financial statements of the parent company drafted according to the new PRC GAAP. This is allowed only if the Accounting records made by the subsidiary are in accordance with the "CAS-basic standard" (Hou et al. 2014).

After the issuance of new IAS/IFRS, the Ministry of Finance usually considers the economic and social environment of the People's Republic of China and consults the various stakeholders, before deciding how to reflect and introduce these new IFRS principles or regulations. If a foreign company adopts the IFRS standards that have not yet been incorporated into the new PRC GAAP, there may be differences between the policies adopted at group level and those adopted in the individual financial statement of

the FIE. This could happen if the group to which it belongs has adopted a principle or an IAS/IFRS regulation, before the official date of entry into force.

In preparing financial reporting according to Chinese Accounting standards, the FIE must comply with new PRC GAAP if inconsistencies between the group Accounting policies and new PRC GAAP are found. This means paying attention to identifying the appropriate policies for group Accounting operations adopted according to IFRS and which are also covered by the new PRC GAAP, otherwise, the adoption of the rules provided only by IAS/IFRS will not be appropriate.

## **Chap 4 WHAT'S NEXT? NEW PRC GAAP, TEN YEARS LATER**

### **4.1 Impacts and results in financial statement**

The process of economic opening and liberalisation, which took place in last decades, is making China more and more in line with the world economy.

According to this perspective, an increase of investors requires financial statements that follow a high level of transparency, objectivity and accuracy.

Being converged with international Accounting standards is a crucial issue, meeting increasingly demanding global needs. In fact, the process of harmonization of Accounting standard may result in a double advantage: it provides transparency and shares confidence among foreign investors, which is the main objective of the latest Chinese economic policies. Moreover, an integrated system at international level simplifies the raising of capital by companies and reduces the risk of financial crisis (Deloitte Touche Tohmatsu, 2007). The NEW PRC GAAP represent the highest level of convergence with IFRS.

Most of the new issued and revised standards refer to the equivalent according to IFRS and follow similar principles and treatments (Ernst & Young, 2006a).

Adopted from January 2007, the new Chinese Accounting standards for business enterprises have improved, as mentioned above, the convergence between Chinese Accounting standards and International Financial Reporting standards (IFRS).

The increase in terms of reliance of the Chinese capital market and the financial reporting system will promote the attractiveness of both domestic and overseas investments.

In addition, Chinese international companies will improve their acceptance in foreign markets the cost of compliance with the Accounting regulations of different countries in which they operate will be reduced. Following international standards, the new ASBEs reintroduce the generally agreed definition of assets and liabilities.

The Accounting items are recognized only if they respect their definition and if the established recognition conditions are met. Some other main features have been introduced: first, the definition of "earnings" and "losses", according to the method of the historical cost as a general requirement for the measurement of the Accounting elements. Replacement costs, net realisable value and fair value are exceptions, which can be adopted in case of reliable determination. Most of the changes are related to guidelines for drawing the financial statement. The principle of "substance over form" still finds application. At the same time, one of the differences with IFRS is related to the exercise

of prudence in the presentation of financial reports. Prudence means that assets and income items should not be exaggerated and liabilities and expenses should not be underestimated. While the new ASBEs prescribe to follow a prudential approach in the recognition, measurement and reporting of transactions, the IASB, regarding the preparation and presentation of the budget, considers prudence as a qualitative feature in terms of impartial evaluation. The new ASBEs reintroduced the concept of fair value valuation generally agreed, for all categories of activities. ASBEs No. 3 (stock ownership), 11 (Share-based payments), 20 (business combination) and 22 (Recognition and evaluation of financial assets) apply this method. A further development also involved the companies' combinations and the form of the consolidated financial statements. ASBEs N. 20 (Business combination) and 30 (presentation of the budget) by exposing Accounting principles and detailed guidelines to address these goals.

The ASBE N. 22 (Recognition and evaluation of financial assets) introduces some items previously out of the balance sheet. Specialized industries, especially in the financial and insurance sectors, must follow new regulations. The ASBE No. 5 (biological assets), 10 (Corporate Performance Fund), 25 (direct insurance contracts), 26 (reinsurance contracts), 36 (information related to related parties) and 37 (presentation of financial instruments) introduced new standards for those companies falling into these industries.

According to ASBE 8 (value adjustments of assets), the loss of value cannot be reversed in future financial periods. More compliance with IFRSs has achieved with the ASBE 28 (changes in accounting policies and estimates and correction of errors), 30 (presentation of the budget), 34 (earnings per share), 35 (segment segment), 36 (Detection of related parties) and 37 (presentation of financial instruments).

Lastly, the ASBE 38 (Adoption for the first time of accounting standards for commercial enterprises) provides transitional provisions for the first adoption of new standards.

The new ASBEs does not simply extend the disclosure requirements.

They make significant and profound changes to previous conventional Accounting procedures in China, so they could result in significant differences in the year-end results or in the valuation of the assets in the financial statements.

The main changes are listed in the following table:

Tab.7

<b>Item</b>	<b>Provision under new ASBE</b>
Share-based Transactions	Their settlement must be measured at the fair value as expenses in the income statement
Business Combination	For entities under not common control it is disposed the acquisition method. Assets and liabilities of acquired enterprise should be carried at the fair value.
Goodwill	Its treatment is not different from indefinite life intangible assets. Likewise, it is not amortized, but the value is annually scrutinized for the impairment test.
Discount on business acquisition	It is treated similarly to the 'credit balance of equity investment difference'. The discount value should be immediately recorded as a profit.
Minority Interests	They should be presented within equity
Non-monetary assets	A grant related to this kind of assets should be presented as deferred income and split evenly over the useful life of the asset.
Reversal of Impairment loss	This category is prohibited to a large extent both for tangible and intangible assets.
Development Costs	Following trends in international standards, now this category of costs should be capitalized.
Borrowing Costs	The expenses incurred for general borrowing should be presented as deferred income and recognized as income along the useful life of the underlying asset.
Derivative Instruments	They must be recognized on the balance sheet with changes in fair value taken to income statement. This provision applied unless these financial instruments are proved to be effective hedging instruments.
Investment Property	The fair value is the criteria to be followed in the evaluation of this item.
Non-Monetary Transactions	Should be carried according to fair value if the commercial substance can be substantiated.
Debt Restructuring	Gains from debt restructuring operations should be recognized in profit or loss.



Financial lease assets	Financial lease assets should be recognized by the lessee at the lower of fair value and the present value of minimum lease payments.
Taxes	The tax payable method is prohibited. Instead the tax effect accounting method should be adopted to record the tax effect of temporary differences.
Hybrid Instruments	A financial instrument featuring both debt and equity components need to be split and the two components accounted separately.

Source: Deloitte (2006).

The increasing parallelism of Chinese systems with international standards is clearly evident, however some exceptions due to Chinese economic conditions (Ernst & Young, 2006a). Chinese Accounting standards prescribe in many cases the generally established fair value requirement. However, when accounting assets, some exceptions are allowed. Giving examples, ASBEs N. 4 (fixed assets) and 6 (intangible assets) only allow the cost model to measure the categories of activities that are given.

This provision is clearly in contrast to the IFRS where the revaluation model is allowed. Biological assets (ASBEs No. 5) shows only a small difference than IFRS.

In this case, the fair value represents the exception to the cost method.

On the contrary, the IAS 41 principle provides for the general approach of fair value, unless it is clearly unreliable in the single case. Another significant difference concerns the record of land use. Under the ASBEs, this right is classified as an intangible asset rather than an operational lease. In the event that the rights of use meet a set of criteria to be recognized as investment properties, the cost model should be the most appropriate principle. ASBEs N. 2 (long-term investment) indicated the equity method as the only accepted way to manage jointly controlled entities, while IFRS allow both the proportional consolidation method and the equity method.

At the same time, the state-controlled entities are exempted from the regulation of the related parties because of their state-owned stake. This special provision is fully in contrast to IFRS. According to ASBEs No. 8 (impairment of assets), the reversal of impairment losses (excluding inventories and trade receivables) is generally prohibited, while IAS 36 prohibits this practice only for the reversal of goodwill impairment value.

The capitalisation method should be applied to those financing costs that meet certain criteria. On the contrary, IFRSs leave the option to measure borrowing costs as expenses. ASBEs No. 20 (Business combination) includes and directs all combinations involving

entities under common control in the same business scope. The same article does not include the inverse acquisition. Finally, ASBEs, as general principles, limit the options available for the measurement of several expenses.

Some cost items must be analysed by function to submitting the income statement.

In this case, the direct method for cash flow statement is required and only gross presentation is permitted for public subsidies relating to activities.

Although the new principles have influenced companies to a different extent, analysts say that Chinese companies have benefited from ASBEs in terms of comparability.

This could lead to an increase in the volatility of financial results due to greater use of the fair value principle. Both differences in adoptions of standards and greater volatility in the year-end results must be explained in financial statement and disclosure to stakeholders. At the same time, loan clauses based on budgetary reports can be broken or become much more complex, resulting in uncertainties about the availability of funds.

As a result, a timely review of the agreements to identify potential issues is a possible measure to address this inconvenience. Another relevant area concerns the implementation of ASBEs. An internal signalling system must recognise what data is no longer needed in the new principles. As a rule, changes and other requirements must be identified in time to enable records identification. Furthermore, the staff and other members involved in the operational decisions, in particular those responsible for governance, should have a thorough knowledge and understanding of the ASBEs.

Over the years, many empirical researches have been conducted to investigate how the ASBEs influence Chinese companies.

Concerning this topic, Heng and Noronha (2011) have analysed about 1500 companies (both A-shares and B-shares), listed in the Shanghai Stock Exchange and the Shenzhen stock Exchange. Starting from the financial performance, the results show that more than half of the selected companies have recorded more operating revenues in new ASBEs than under the old standards. Up to 30% maintained the same operating income in both sets of standards, while only a residual part significantly reduced operating revenues in the new ASBEs. As far as profit is concerned, most companies have achieved higher results. This result may be read in relation to the new treatment of debt restructuring.

In fact, the new ASBE No. 12 recognizes the positive differences resulting from a fair value in debt restructuring, as profits to be recorded in the income statement.

The same principle applies to ASBE N. 22 "Recognition of financial instruments" with all changes in fair value to be recognised in the income statement of the period.

In addition, new treatments provided for both loan costs (ASBE No. 17) and intangible assets (ASBE No. 6) allow companies to capitalize on expenses, while these have been fully registered as period expenditure under previous rules.

Finally, in 60% of cases, there was a sharp increase in the basic earnings per share in the new ASBEs. The broader differences can be assessed when comparing profit before taxes and net profit before extraordinary items, in which up to 70% of enterprises achieved higher outcomes. The results are quite different when comparing the differences occurring in the cash flow under the new ASBEs. Considering the net cash flow from operating activities and net cash flow from operating activities per share, more than 40% of the entities did not show any appreciable change in their financial statements.

The residual part of the enterprises (about 55%) has been shown as equally shared between the increased and diminished results.

In terms of total assets (current and non-current) and equities, 70% of the enterprises analysed have recorded an increase in total assets and total activities per share under the new ASBE. The residual percentage refers mainly to those entities that have faced a decrease in the value of total assets and total assets per share, while few companies have left their value unchanged. In order to give reasons for these change, the researchers focused on ASBE N. 1 (inventories), ASBE N. 3 (Real estate Investments), ASBEs N. 4 (fixed assets), ASBE N. 5 (Biological activities), ASBE N. 6 (intangible assets).

The inventories have resulted in a higher assessment, due to the new provision of ASBE N. 1 that does not allow LIFO method (Last-In-First-Out) to evaluate the title.

As prices raised, only those which have come later are considered.

Regarding both raw materials and intangible assets (ASBE No. 3, 4, 5 and 6), the main changes in fair value valuation and cost capitalisation have led in many cases to a significant increase in the recorded value of assets.

A similar distribution has been followed in the scheme of equity compartments attributable to shareholders. Here the relevant principles concern ASBE N. 11 (Share-based payments) and ASBE N. 22 (Recognition and evaluation of financial instruments). However, the new provision provides that payments made through shares must be recorded at fair value. At the same time, the recognition at fair value of financial instruments gives all profits deriving from the difference between fair value and book value to adjust the initial equity funds.

The great effort put in place by the Ministry of Finance has really changed the financial information published by the Chinese companies, which are now strictly comparable to

those according to IFRS. Some fundamental differences between ASBEs and IFRS, largely related to the unique characteristics that characterize the Chinese economy, should be considered a further starting point for the harmonization of systems.

## **4.2 China's further steps in pursuit of its convergence program with IAS**

There were further developments after the mandatory adoption of New PRC GAAP, on 1st January 2007, to improve the convergence with IFRS.

This represented an important leap forward for Chinese Accounting and Chinese economy in general. This convergence process is an outcome of the call from G20 and the Financial Stability Board (FSB), aiming to the establishment of a single set of high quality Accounting standards. After 2007, there have been a series of documents, in order to assess the status of convergence of Chinese Accounting standard.

Firstly, the « Roadmap for Continuing and Full Convergence of the Chinese Accounting Standards for Business Enterprises with the International Financial Reporting Standards» published by Chinese MOF, on 2 September 2009.

This Roadmap had the purpose to officialise that China would have tried its best to continue the convergence process. It was published in compliance with G20/FSB recommendations. It is composed of three main topics. The final goal was to reach a full convergence of Chinese New PRC GAAP with IFRS in a short period of time (Report on the Observance of Standards and Codes, 2009).

CASC and IASB said in this document that a proactive working mechanism was needed to be set up, and that required two technical meetings per year, in order to have a detailed analysis of what happened and what will happen in the recent Chinese Accounting future. In 2012, Chinese MOF also founded the Asian-Oceanian Standard Setters Group (AOSSG), an association of Asian-Oceanian Accounting standard-setters.

The purpose of the group was to create a discussion and share experiences about the adoption of IFRS and to give an outstanding contribution to the development of a high-quality set of global Accounting standards and encouraging the adoption of IFRSs in the region. Therefore, its main objectives are the promotion of the adoption and convergence process with IFRSs by jurisdictions in the region, support a coherent application of IFRS and regulate the inputs from the region to the technical activities organized by IASB.

The second part focuses on the efforts made by ASBE and IFRS to eliminate the few differences that still exist between the two Accounting standards systems.

The last part of the Roadmap schedules the main projects for the continuing and full convergence of ASBE and IFRS. IASB clearly expressed its desire of accomplishing its main projects by 2011. This same year is here considered as the target year for the continuing and full convergence project. This Roadmap is crucial to have a better understanding of the steps that came after the first convergence process' step.

On April 2012, the CASC issued the "Guiding Opinions on Further Reforming the Issue System of New Shares" (CASC 2012). A significant aspect of this reform was the reduction of administrative interventions over the next two years, with the aim of improving the basic rules for share issues of joint stock limited companies, listing and trading of their shares. Moreover, to enhance market participants to properly play their roles and the promotion of a reliable reflection of the value of a company through its share prices. Finally, the realization of the balanced and coordinated development of both primary and the secondary markets and the protection of rights and interests of investors. In the first section of the document, called "Improving rules, clarifying responsibilities and strengthening true, accurate, sufficient and complete information disclosure", it is said that information disclosure system needs further developments.

Another requirement is the reduction of the reliance on the regulatory authority's judgments on the profitability of companies that will be later listed.

This condition can be met only through the amendment and improvement of rules. Information disclosure requirements shall also be improved.

Another essential point that CSRC highlighted was the quality of information disclosed. Issuers and intermediaries shall perform their duties in compliance with laws, regulations and rules and may not disguise poor business performance of applicants.

They shall deal with matters according to laws, regulations and rules, following the fundamental principles of good faith and professionalism.

Issuers are responsible for information disclosure, thus they must adhere to the rule of conduct of good faith. Their fundamental duties and responsibilities are to provide Accounting information users with reliable and complete financial Accounting informations. Sponsors shall comply with business rules and industry standards by acting in good faith, and fulfilling their duties. They shall care about the information disclosed by issuers and encourage issuers to provide complete and unbiased disclosure of basic information and risk factors, also conducting necessary verifications of the professional

judgements issued by other intermediaries. Accounting firms shall set up review and quality control rules. Certified public accountants shall respect their code of practice and shall apply quality control rules, assuring the expected execution of important audit procedures, such as risk assessment, maintain rational professional skepticism, maintain sensitivity to suspect financial information, and preventing frauds, earnings manipulations and other acts concerning the management.

Accounting firms and certified public accountants shall provide audit reports, review reports or other assurance reports in compliance with their rules. Another important topic in this document expressed the key concept that to reach a better quality of financial information disclosure, issuers and controllers shall respect their duties and any form of disguising information must absolutely be prohibited. Issuers shall establish a specific corporate structure, improve internal control rules, and set up a strategy for the protection of rights and interests of shareholders, especially minority shareholders.

The fourth section of the document concerns the required regulations and punishment in case of violation or misconduct.

CRSC has worked to limit the occurrence of financial disclosure violations.

It made several efforts to avoid false financial information disclosures.

For violations in the process of new share issues, such as financial frauds, profit manipulation and false disclosures, the relevant self-regulatory organisations shall take self-regulatory measures in accordance with their self-regulatory rules, while the CSRC shall be responsible of taking measures such as regulatory measures or administrative punishment against the legal representative, financial chief and other relevant personnel of a company and the relevant personnel of an intermediary in accordance with law.

Those suspected of any crime shall be transferred to the judicial authorities for criminal investigation. Where there are any express provisions of law or regulation, a heavier punishment shall be imposed in accordance with law.

Where there are no clear provisions of law or regulation, further improvements shall be made. On May 2012, the CASC issued the “Opinions on Issues concerning Further Improving the Quality of Financial Information Disclosure by Companies Undertaking an Initial Public Offering”. This document has been issued to implement the significant requirements outlined in the “Guiding Opinions on Further Reforming the Issue System of New Shares”. The purpose of this document was to keep improving the quality of financial information for companies undertaking an initial public offering (IPO), to increase reporting transparency and to promote the fulfilment duties of all market

participants while issuing new shares. The first section called “All market participants shall diligently perform their respective duties to effectively improve the quality of financial information disclosure”. Financial information is fundamental for issuers that should prepare a financial prospectus. According to share issue supervision, however, some problems have been found regarding the quality of financial information disclosure. In particular, financial information disclosed by some issuers lacks relevance or completeness, or some issuers adjust Accounting policies, avoid important issues, or disguise financial statements, to the extent that some issuers are suspected of presenting false business performances or manipulating earnings.

This document, written by the CRSC warned issuers, Accounting firms and other market participants that a great attention should be paid to resolve the existing problems in terms of financial disclosures, in order to improve the quality of financial statements of companies undertaking an initial public offering.

An issuer should apply the provisions outlined in the Accounting Law and in the Accounting Standards for Business Enterprises to ensure the standardisation of the basic Accounting work, to prepare accurate and reliable financial Accounting reports composed by authentic and complete financial Accounting information and assure the authenticity, accuracy and integrity of the financial information disclosed in a prospectus.

The controlling shareholder or controller of any issuer shall not allow or help an issuer to falsify financial data, manipulate earnings or intentionally omit the disclosure of any important financial information thanks to their status.

An Accounting firm and its certified public accountants shall issue audit reports, examination reports or other assurance reports. An Accounting firm should also further improve the quality control system and strengthen internal management.

An Accounting firm and its signatory certified public accountants shall effectively fulfil quality control procedures and maintain their independency during their practice, avoiding being involved in any specific accounting treatment or preparation of financial reports for an issuer. In September 2012, the CSRC released the revised standard “No.2 for Contents and Formats of Information Disclosure by Companies Publicly Offering Securities —Contents and Formats of Annual Reports”.

This is another evidence of the fact that CSRC, after the convergence process, has made great efforts to reach a better level of compliance with IFRS. This revised standard has been issued to enhance the transparency of Chinese Accounting practices and to make Chinese financial reports more effective.

The CSRC also issued the No.1 and No.2 “Regulatory Guidelines for Listed Companies, in order to simplify and fulfil the correct disclosure requirements.

In December 2012, the CSRC decided to launch an ad hoc inspections program, with the specific aim enhancing the quality of Accounting information.

During these inspections, Accounting firms were asked to carry out a self-examination of the financial and Accounting information in terms of prospective issuers and then submit the self-examination reports. These further developments that occurred throughout the years, after 2007, have shown that the convergence process continued.

In 2014, the Chinese MOF have issued three new ASBEs (CAS 39 Fair Value Measurement, CAS 40 Joint Arrangements, CAS 41 Disclosure of Interests in Other Entities) and revised five of them<sup>47</sup>(KPMG, 2014).

Moreover, several Exposure Drafts in 2015 and 2016 were issued, which are in continuing convergence with IFRS. The most recent development occurred on 24 November 2015, when the MOF and the IFRS Foundation signed a joint statement in Beijing, on the Trustee’s final meeting. In this late Joint Statement, IFRS and Chinese MOF assert again that their future goal is the full convergence between New PRC GAAP and IFRS, enhancing the continuation of their cooperation.

They signed this new Joint Statement because of the great results achieved after the first Joint Statement of 2005. In that meeting, the fundamental point that Chinese New PRC GAAP are substantially converged with IFRS were highlighted, emphasising the fact that the use of these new standards has noticeably improved the quality and the transparency in financial reporting in China. Both participants of the meeting underlined the importance of the international support for reaching the goal of one single high quality set of Accounting standards, that complies with the G20 fixed objectives. This statement has been signed exactly ten years later the memorandum of substantial convergence of New PRC GAAP with IFRS.

Many progresses have been made, but there are obstacles that, even enhancing the cooperation between the two parties, are difficult to be overcome.

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<sup>47</sup> Currently, Chinese ASBE are composed of 41 Standards



### **4.3 Cultural and practical obstacles to the implementation of IFRS-converged Chinese Accounting Standards: a starting point for further research developments**

As already mentioned, Chinese environment has its own unique features, comparing to other countries. Concerning Europe, the issuance of IFRS is an evidence of the will of the IASB to develop a single set of principle-based global Accounting standards.

China has tried to comply with this principle-based approach, ending up in a substantial convergence with the IFRS, recognised by IASB in 2005.

However, given the fact that Accounting is influenced by the social, cultural and political environment of the country, many studies have focused on how IFRS-based standards can be implemented effectively in a completely different social and cultural environment.

A significant requirement for working in a principle-based manner is to application of professional judgement. Therefore, it is important to assess how effectively professional judgements can be exercised in China. The educational background of accountants may result in different judgements, because it has a significant influence on their future decisions. Some studies show that the convergence with IFRS is substantial, through a comparison between the 2006 CAS with IFRS (Peng and Van der Laan Smith, 2010; (Qu and Zhang, 2010). These studies have significantly questioned the feasibility of the IFRS convergence in China due to its unique Chinese characteristics.

It is showed that Confucianism had consistently affected both Accounting education and professional ethics in contemporary China. As a consequence, the professional independence and objectivity of Chinese Accounting professionals have been compromised. The concept of independence is not only related to the auditor, but also refers to the impartial and neutral mind-set that an Accounting professional should have. Thanks to the abovementioned researches, it is believed that Chinese Accountants lack independence and objectivity. The main reasons that have emerged are connected to *wulun* (hierarchical structure) and *guanxi* (clientelism).

These two factors have a strong influence on Chinese professionals. As far as *wulun* is concerned, the younger party is expected to respect and obey to the older party, without raising any questions (Tu, 1998). Therefore, a hierarchy has been created during ages.

Accounting firms are likely to hire young graduates. As a direct consequence, Junior auditors often hesitate to question their clients, who are often older than them.

The obligations and expectations created by Confucian culture have influenced Chinese professionals' thoughts and are not in line with the concepts of independence and

objectivity. Exercising a fair judgement may be difficult in Chinese cultural environment. According to the Confucian *wulun*, junior auditors are likely to be intimidated by their senior clients. This kind of hierarchical societies are hostile to provide a suitable basis for the development of professional scepticism and independence.

Studies has shown that another reason of this lack of freedom may also be related to the Chinese Accounting education system. The teacher-centred approach used in Chinese teaching, is unlikely to improve students' critical thinking abilities and push them to reproduce what their teachers said. Because of this lack of critical aspects in their learning, students do not develop a critical way of thinking. Although professional scepticism can be developed with experience, under the influence of *guanxi*, auditing partners are unlikely to challenge their clients. Peng and Bewley (2009) believe that in China there is an intense competition in auditing market. To survive in the market, auditors need to please their clients without modify their opinion. It is necessary to establish *guanxi* with clients through giving benefits. Such benefits can take different forms, such as dinners, gift cards, trips and kickbacks. Is it known as an "unspoken rule" in auditing industry.

The findings highlight that the market does not demand independent auditors.

In other words, auditors who are independent may suffer from losing their clients.

This is an evidence of the reason why there is no need to teach students how to exercise independent opinions, because there are no employers that would like to hire independent employees. The concepts of independence and objectivity are not considered as values in the Chinese context. The relationship between accountants and their supervisors tends to be hierarchical. An accountant needs to be obedient, whereas the responsibility for a supervisor is to instruct. However, according to studies, accountants are essential for assisting managers because they want their accountants to prepare the budgets in the way they intend. Managers have also to establish their *guanxi* with local officials to make progresses in their career. These *guanxi*, close to Western corruption behaviours, are often established through monetary benefits and the accountants are involved in releasing the money to managers, concealing such expenditures.

Accountants hide transactions or operate Accounting procedures in the way that their supervisors require. The supervisors usually reward the accountants with promotion, bonuses or overseas travel opportunities if they follow the instructions.

This reflects that the interests of supervisors and accountants are tied together because of *guanxi*. In addition to *guanxi* and *wulun*, Peng and Bewley provides insight into

worldwide Accounting issues by critically assessing China's experience in converging with the IFRS' fair value-related Accounting standards.

Using fair value means that an asset is taken at its market value in the financial statement, without considering its historical cost, that is the acquisition price.

This method allows the users of the financial statement to have an accurate idea of what is the real value of the asset at the drafting time.

The Chinese adoption and implementation of fair value measurement has derived from IFRS in response to internal pressures due to the rapid development of its market economy and to external pressures from international organizations, aiming to uniform and simplify Accounting international practices. However, in terms of use of fair value, significant differences have been found between Chinese Accounting standards and IFRS. China is already into the full adoption of fair value dealing with financial instruments, but not with non-financial instruments, such as real estate, equipment, machinery or vehicles. This should be red comparing China to developed economies,

China's less developed market economy and less advanced pricing techniques make much harder to obtain reliable and fair prices for non-financial instruments than for financial instruments. This context justifies the restriction made by CAS on 2007, about the use of the fair value model for subsequent measurement of PP&E and intangible assets, forbidding the use of estimation techniques to determine the fair value of investment properties and biological assets and discouraging the use of the fair value model in favour of the cost model. This divergence is due to specific economic and political environment of China and seems unlikely to be overcome in the near future.

This reflects that the IASB's purpose of having the same set of standards applicable to all countries, without consider other aspects, may be too optimistic.

China has developed its own version of fair value Accounting that differs from IFRS and this challenges the IASB's goal of uniform Accounting. The divergence is unlikely to be bridged unless IFRS can be revised by IASB and include exceptions among countries. The statement by the Chinese Ministry of Finance and the International Accounting Standards Board (IASB) that "a company applying Chinese Accounting Standards should produce financial statements that are the same as those of a company that applies IFRS" (IASB, 2006, pp 1) has not, in fact, been achieved.

Therefore, as Olesen and Cheng (2011) discuss, and as it shown in their study, convergence of Accounting standards does not always lead to the convergence of Accounting practices. Issues of culture and practice need further in-depth study.

The outcomes from the studies that have already been made suggest that the *de facto* convergence of Chinese Accounting system is not substantial in practice.

Despite the remaining differences, there were consistent improvements and efforts by Chinese standard setters and regulatory bodies, to achieve a good level of uniformity.

It is unclear whether the most recent fair value reform will be successful.

Empirical studies are needed in order to observe how firms react to latest fair value regulations and whether implementation obstacles can be overcome in practice.

## CONCLUSION

Accounting is the tool by which companies identify, measure and communicate data and information to various stakeholders.

Differences in this type of language make it difficult to interpret data from companies belonging to different countries. In this sense, the studies in International Accounting have dealt with the inequalities in Accounting between countries, but also the analogies, identifying macro areas, such as the Anglo-Saxon area and Continental-European area (Nobes, C.W., 1998, 2006, 2011, 2013).

With the introduction of IFRS, the agreed countries expressed their willingness to internationalized their Accounting systems and thus reduce the generated differences with the application of local GAAP. The rapid economic development of China over the last 20 years has certainly led to a significant impression on the rest of the industrialized world. After the entrance of China to the WTO, industrial and commercial activities within China and outward were further amplified.

It is known in the Economic community that China's influence on the world economy has considerably increased over the last decades.

Moreover, the Chinese government has gained greater awareness of the importance of a solid Accounting information system in every economic development process.

The Chinese Ministry of Finance (MOF), having the responsibility to regulate the Accounting laws in China, has put on top of its agenda the intention to increase its involvement in the issue. The aim is to increase investor confidence regarding Accounting information, by improving the transparency of financial statements and the harmonization of local principles with IFRS, to reduce the cost of raising of capital by companies and the risk of financial crises. So far, the progress made by China in the overall process of harmonizing national Accounting standards with IFRSs has been remarkable.

The Ministry of Finance, with the support of the Accounting consultancy firm Deloitte Touche Tohmatsu, has made great effort in order to develop an organic set of Chinese Accounting standards in line with Accounting International practices.

The Accounting systems that had appeared at the beginning of the last century, were conceived to meet the needs of a planned economy and therefore were structured to facilitate State enterprises 'verification of the achievement of the productive, financial and economic objectives.

Since China has opened its borders to foreign capital investment in 1979, its rapid economic growth, international trade and the stock market have highlighted the need to take a new dimension for issuing the financial statement.

Nowadays, state-capital companies have the ultimate goal of generating profits, and both the governing body and the associated stakeholders have, in this sense, the need to receive reliable financial information on which to base their decisions about the efficient allocation of available resources. Meanwhile, China has opened to foreign countries by forming joint ventures with foreign partners and gaining more opportunities to access to more advanced technologies and international capital. Such an economic situation, with increasing growth rates, required the creation of a theoretical-Accounting model able to meet the needs of investors, creditors as well as the needs of shareholders and governments. This has resulted in the consequent need for important reforms in the field of Accounting system, reforms that took place in the last two decades.

The enactment of these regulations, represented a milestone in the history of Chinese Accounting system, since through them were introduced new and more complex Accounting concepts and essential elements of financial statements based in many respects on International Accounting system. It should be noted that those regulations showed substantial differences with international Accounting practice.

Since the financial statements of foreign-capital companies prepared in compliance with the Accounting Regulation for foreign investment enterprises (FIE) were unable to correctly reflect the financial situation and the operating result of the companies concerned, these were in the difficult position of having to make several adjustments at drafting time of the budgets according to the Accounting standards in use overseas, required by foreign investors.

This process involved a considerable amount of time and was an additional cost to foreign investors. Following the adoption of the new System, the differences between the corporate balance sheets of foreign-owned companies drawn up based on the New PRC GAAP and those prepared in compliance with the International Accounting practice have been reduced, allowing investors to evaluate the viability of their investments in a more comfortable way. Moreover, since the new system has introduced more information requirements, the clarity of financial data has improved further.

The adoption of the New PRC GAAP has become compulsory for all listed companies, for non-listed and for public financial companies, marking a period of fundamental transition in the Chinese race towards an ever-greater internationalization and a global

development. From the date of the introduction of these new principles to the present, China has been shown to be seriously committed to extending its adoption to small companies as well, showing in line with the prospect of international economies.

In fact, this reform has had an innovative and consistent value.

First, the criterion of substance prevalence on form was introduced.

The New PRC GAAP also introduces the concept of "fair value", which integrates the method of the historical cost provided by the old Accounting standards.

The objective is to ensure that the financial statements indicate market-based values and therefore that the assets are entered in their current value at the drafting time of the documents. However, despite the substantial convergence with the IFRS principles some differences continue to remain. Those are attributable to the fact that, even in the presence of international standards, the preparers remain local and therefore are influenced by their Accounting practices, their culture or the legal and fiscal system in use in their country. The emergence of such differences is empirically evidenced by the choices made by the preparers in the policy options present in the IFRS principles (Kvall and Nobes, 2010, 2012). These differences, connected to the classifications carried out since the Sixties, that was mentioned above, still lead to the emergence of two groups, the Anglo-Saxon group countries and those of European matrix (Continental European Group), to which correspond different legal systems but also two different conceptions of the financial reporting purposes, the first to shareholders and the second to the tax authorities and the credit system. The position of the emerging countries is unlikely to be found in the classifier studies because of various reasons: from the backwardness of these countries, to problems related to the language or to the Accounting system hardly interpretable. Among the emerging countries, China, as a well-established world power, represents an interesting case of study because it has carried out a different path than the other emerging countries that did not mean the complete abandonment of local principles (PRC GAAP) for the adoption of IFRS, that was implemented by other developing countries such as Brazil, Russia and South Africa which are instead IFRS fully converged. Statistical researches have shown, connected to the classification proposed by Nobes (2011, 2013), that China is more akin to countries with Continental European tradition than the Anglo-Saxon ones. This data is also confirmed by the historical analysis of Accounting in China. A substantial part of the economy is dominated by state-owned enterprises, and despite their transformation into stock companies and separation from government structure, the

central or local government remains their shareholders, still having a significant influence on them, their business partners and their business in general.

Many business operations, have political motivation rather than goals related to proper business management. Moreover, as already mentioned, China is a tax-oriented country, with capital markets not fully developed yet. For these characteristics, the approach chosen by the Ministry of Finance was to create a set of Chinese Accounting standards tending to converge with IFRS, but which take into account the peculiarities of China.

In fact, a complete adoption of the IFRS principles is unlikely to be achieved, but China's objective is to become uniform as much as possible to the international standards issued by the IASB. Undoubtedly, this process of uniformity, not only represents a milestone to consolidate the process of economic development of the country, but it is also a necessary step to define the role that China will play in a future as a fulcrum country in a market of globalised capital.



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