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Xinyun Miao†

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1 . Introduction

Consistent with the apparently increasing globalization of capital markets and significant growth of multinational enterprises, a uniform set of international accounting standards is required to enhance the comparability of financial reporting over the world. It is believed that with the enhancement of comparability of financial reporting, capital flow across countries will become effective (Choi & Meek, 2011, p.41; Doupnik & Perera, 2012, pp.31-32). With the aim of reducing differences in financial reporting among countries, the International Accounting Standards Board (IASB) was established mainly for the purpose to develop a set of uniform and so-called "high-quality" financial reporting standards that can be used internationally, known as International Financial Reporting Standards (IFRSs).

The IASB works in close cooperation with national standard-setters, such as Financial Accounting Standards Board (FASB) in the USA and Ministry of Finance (MOF) in China, to facilitate international convergence of national accounting standards and IFRSs, with the aim of promoting the use and rigorous application of IFRSs. As a result of the cooperative efforts by

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these organizations, during the last few years, especially after 2005, when IFRSs was adopted mandatorily in the EU for all listed companies, the number of countries which have adopted IFRSs has been increasing (Hellmann et al., 2010, p.108). According to the survey conducted by Deloitte,[1] over one hundred countries[2] have permitted or required IFRSs to be used for financial reporting as national standards. In the global trend of convergence towards IFRSs, the countries which are traditionally grouped in the "Continental-European model", such as Germany and France, also adopted IFRSs as national standards (Nobes, 1992; Doupnik & Perera, 2012, p34; Tsunogaya et al., 2011, p.2). In addition to industrialized countries that have adopted IFRSs, many developing countries, such as Brazil, South Africa and Turkey, also permitted or required general purpose financial statements to comply with IFRSs.

IFRSs reflect the Anglo-American accounting model that in broad sense was developed in English-speaking countries such as the UK, the USA, Canada, Australia and New Zealand (Doupnik & Perera, 2012, p.34). This model focuses on investor orientation, fair value accounting and extensive application of accountants' professional judgment (Haller & Walton, 2003, p.28; Hellmann, 2010, p.108). Moreover, this model has developed over a long period of time in an environment characterized by developed capital markets with investor orientation, common law, separation of accounting and income tax schemes, and well-established accounting professional tradition (Tsunogaya, 2011, p.2). As such, the focus on convergence of financial reporting which is consistent with the Anglo-American model may hinder the *de facto* convergence for those countries that have adopted the "Continental-European model" for developing countries which have adopted different accounting standards to reflect their specific accounting environments (Ball, 2006; Hoarau, 1005; Perry & Noelke, 2006; Hellmann et al., 2010, p.108; Tsunogaya et al., 2011, p.2).

Moreover, in this trend of global convergence towards IFRSs, major countries have showed their concerns against direct adoption of IFRSs. For example, in USA which has adopted the "Anglo-American model", in 2011, the U.S. Securities and Exchange Commission (SEC) proposed 'Condorsement Approach' to incorporation of IFRSs in the U.S. GAAP rather than direct adoption of IFRSs in the staff paper: *Work Plan for the Consideration of Incorporating International Financial Reporting Standards into the Financial Reporting System for U.S. Issuers: Exploring a Possible Method of Incorporation*. Japan, which has used the "Continental-European model", also confronts intense domestic opposition to unquestioning adoption of IFRSs. Because Japan has well-organized financial reporting-related infrastructures, it is stated that it would be

1) The result of the survey by Deloitte up until Feb 28, 2012 is showed on http://www.iasplus.com/en/resources/use-of-IFRSs/#totals.

2) These countries refer to the ones in which audit reports state compliance with IFRSs, including IFRSs as adopted by EU.

futile to adopt IFRSs without adjusting to related facilities and resources. As such, Japan adopted a so-called 'cautious convergence' approach, in which Japan will not apply IFRSs directly and uniformly, but will manage to reduce disparities in financial reporting and in other infrastructures, such as particular Japanese business practices, accounting-related legal system, and close relation between accounting and corporation income tax scheme (Tsunogaya et al., 2011, pp. 2-3).

The accounting regulator in China, namely the Ministry of Finance (MOF) which is confronted with IASB's pressures to adopt IFRSs also rejects to apply IFRSs unquestioningly, and suggests eliminating differences between IFRSs and Chinese GAAP gradually with considerations about particular accounting environment in Chinese context (Yang, 2011). This is also called 'convergence approach', which means that China continues to develop Chinese GAAP by integrating, amending or substituting IFRSs, with the aim to gradually reduce diversity of financial reporting under Chinese GAAP and under IFRSs. Yang, M. (2011), the Director-general of Accounting Department under the MOF, states the reasons for 'convergence approach' rather than 'direct adoption approach' as follows:

> Because, considering Chinese legal environment, codes of language, practical problems solving, implementation of accounting standards and grasping the initiative and flexibility[3] (of accounting standards setting of the MOF) in the trend of accounting globalization, adhering to 'convergence approach' is a pragmatic and effective way to meet the needs of accounting standards establishing and developing (in China).

Indeed, Chinese policymakers and standard-setting body, such as the MOF follow two objectives: (1) enhancing the international comparability of financial reporting to integrate the Chinese economy into the global economic system and to increase the attractiveness of Chinese capital markets; and (2) fulfilling particular needs of the political economy, such as increased production, employment and industrial reorganization (Tsai, 2006; Ezzamel et al., 2007; Biondi and Zhang, 2007; Baker et al., 2010). Both objectives are equally important in China because China has the second largest capital market in Asian, namely the Shanghai Stock Exchange. Moreover, China is during the transition from a state controlled economy to a market-based economy. The equal emphasis on two objectives differs from the stated objectives of the FASB and IASB, which place the information needs of capital markets at the core of everything (Baker, 2010, p.107).

Indeed, Chinese authorities regard the advantages of converging towards Western accounting practices in order to integrate the Chinese economy into the global economy and promote the development of capital markets to facilitate capital flow. On another front, Chinese authorities

3) Indeed, as a result of 'convergence approach' in which the MOF renews Chinese GAAP through a fine process of integrating, amending or substituting IFRSs, the institutional independence as regulator has been maintained (Biondi et al., 2007, p.705).

also argue for an exception to international standards for socio-economic reasons and Chinese uniqueness and exceptionality (Ezzamel et al., 2007; Baker et al., 2010, p.110). Finally, Chinese policy markers adopted a 'convergence approach' resulting in an accommodation with international standards, but with modifications to suit the Chinese unique contextual factors (Tsai, 2006, 2007; Peng and Bewley, 2009) and the maintenance of an autonomous set of Chinese accounting standards (Baker et al., 2010, p.110).

A number of research have examined the influence of various Chinese unique accounting environment on accounting practices in China (Winkle et al., 1994; Chow et al., 1995; Davidson et al., 1996; Graham et al., 1997; Xiao et al., 2004; Ezzamel et al., 2007; Zhang & Lu., 2007, pp. 193-217; Biondi et al., 2007; Peng & Bewley, 2010; Baker et al., 2010; Doupnik & Perera, 2012, pp.235-254). While previous research provided useful insights to understand specific Chinese accounting system, the topic with respect to convergence of financial reporting and the relevant Chinese contextual factors have been largely ignored. As such, this paper aims to provide a rigorous and systematic analysis of the main features of China's accounting environment, using the accounting ecology framework developed by Gernon and Wallace (1995). The main objective of this paper is to show that accounting as the language of business is deeply embedded in a country's social, political, economic, cultural and professional environments and that the influence of these contextual factors cannot be ignored in the process of achieving *de facto* convergence with IFRSs.

Specifically, the unique contextual factors in China have hindered de facto convergence of Chinese accounting standards with IFRSs. The Chinese cultural tradition originates in the teachings of Confucius, which respect long-term corporative relationships and avoidance of conflicts. Consequently, the reforms happened in China, including the international convergence towards IFRSs have been concluded as an experimental, incremental, and cumulative process of reform. In addition, the fact that financing through capital markets is not paramount to Chinese enterprises, and high concentration and illiquidity of Chinese capital markets results in that the information needs of investors and creditors in capital markets may not be the central focus of the Chinese standards setting body, namely the MOF (Biondi and Zhang, 2007, p.696; Baker et al., 2010, p.111). Moreover, weak accounting profession environment in which Chinese accountants are lack of accumulated experience, past education and cultural background as a basis for making judgments forms a significant barrier to effective implementation of principles-based accounting standards, such as IFRSs (The Institute of Chartered Accountants of Scotland, 2010, p.7).

The finding of this study may contribute to the development of Chinese accounting standards aiming to achieve *de facto* convergence with IFRSs, by providing insights into the Chinese accounting ecology in which accounting practices operate. The findings also may be of interest to international accounting researches, professional bodies, enforcement bodies, and multinational corporations not only in China but also in other countries which are in the process of convergence towards IFRSs.

The remainder of this paper is organized as follows. Section 2 summarizes the accounting ecology framework developed by Gernon and Wallace (1995). Section 3 uses this framework to clarify the main features of China's accounting ecology, including social, organizational, professional, individual and accounting environments. Section 4 concludes this paper by summarizing China's accounting ecology.

2. Theoretical Framework

This paper uses the framework developed by Gernon & Wallace (1995) to provide a rigorous and holistic analysis of the accounting environment in China. They describe the environment in which accounting operates by using the term 'accounting ecology'. According to this concept, the accounting environment includes the following five divided yet interactive slices.

1. Societal Slice: including cultural variables such as language, ethnic origin, religion, belief systems, share values, and structural variables such as economic, political, legal system, coupled with demographic variables.
2. Organizational Slice: referring to the elements as organizational size, technology, complexity, culture as well as human and capital resources. It can be examined by variables such as capital market related variables (e.g. primary domestic listing status, entrance into a foreign capital market, and raising funds in bond market), size of audit firms.
3. Professional slice: refers to the education, training, registration and discipline of accountants and auditors.
4. Individual slice: pursuit of individual interests affects accounting policy choices. The influence comes from the groups of standard-setters, regulators and users of standards and reports.
5. Accounting slice: accounting does influence the external environment proactively. It encompasses financial reporting rules, auditing practices, regulation and so forth (Gernon & Wallace, 1995).

The appropriateness of using the accounting ecology framework to analyze the accounting environment in a country has been displayed by Perera and Baydoun (2007), Baker et al. (2010), and Hellmann et al. (2010) who examine the special accounting environment in Indonesia, China, and Germany respectively.

3. Chinese Accounting Environment

3.1 Social Environment: Economic, Legal, Cultural Factors

China has achieved the fastest growing economy for more than 30 years since 1979, with an average growth rate of about 9.9% per annum[4]. In terms of nominal gross domestic product (GDP), China is the world's second largest economy, after the United States (IMF, 2012). However, China ranked ninetieth in 2011 with regard to nominal GDP per capita (IMF, 2012). The difference of rankings between GDP and GDP per capita is mainly due to that China has the largest population in the world (1.37 billion in 2010), which is used as a denominator in calculating GDP per capita. In addition to GDP, China has been recognized as the world's top exporter in the past several years with the EU, the United States and Japan as its most important trading partners, as well as one of major recipients of foreign direct investment (FDI) (Athukorala, 2009, p.260; Doupnik & Perera, 2012, p.235; Chinese Statistical Yearbook 2011). As a result of its integration into the global economy, China is increasingly under the pressure to harmonize not only its business activities but also its accounting standards and practices with international standards, namely, IFRSs. (Kanbur & Zhang, 2005, p.96; Biondi et al., 2007, p.700; Doupnik & Perera, 2012, p.245).

In addition to these economic factors, accounting-related laws have also influenced accounting practices in China, which include the *Accounting Law*, the *Company Law*, the *Securities Law* and the *Corporation Income Tax Law* (Zhang & Lu, 2007, p.196). These laws are codified and follow formal due processes for enacting laws involving several institutions such as the National People's Congress[5], the MOF and the China Securities Regulation Commission (CSRC)[6]. The *Accounting Law* requires all enterprises to apply the Chinese GAAP established by the MOF (Article 8). The *Company Law* requires all corporate entities to submit audited financial statements prepared under the Chinese GAAP to general meetings of shareholders (Article 166). The *Securities Law* requires all listed companies and companies with publicly traded corporate bonds to submit interim and audited annual financial reports prepared in accordance with the Chinese GAAP to the CSRC and relevant securities exchange (Shanghai or Shenzhen stock exchange), as well as to disclose these financial reports to investors (Article 65, 66). Additionally, the calculation of taxable income is, in general, based on the Chinese GAAP, unless there are special rules in the *Corporation Income Tax Law*. As such, although the objectives of these laws

4) The average GDP growth per annum during 1979-2010 is calculated based on the World Bank open data.
5) The National People's Congress is the only legislative house of China.
6) The China Securities Regulation Commission is the regular of Chinese capital markets, equivalent to the USA Securities and Exchange Commission.

are different, they are integrated with each other through requiring enterprises to prepare financial statements in accordance with the Chinese GAAP.

Together with economic and legal factors, unique cultural factors have also played an important role in Chinese accounting practices. Firstly, the language is a major element of the culture in a country. China has 56 ethnic groups with more than 80 distinct languages and dialects throughout the nation. Among these languages, Mandarin is used by more than 90 percent of all Chinese population and has been adopted as national language. Accordingly, it is a legal requirement that financial statements of companies have to be prepared in Mandarin. In the process of international convergence towards IFRSs, proper translation of IFRSs which is established originally in English into other language is crucial (Evans, 2003, p.210; Hellmann, 2010, p.110; Zeff, 2007). In particular, full equivalence of technical terms and accounting concepts in translation between English and Mandarin is rare (Cao, 2002). Thus, to achieve *de facto* convergence, an accurate translation of technical terms and accounting concepts included in IFRSs into Mandarin is of great importance. Especially the concepts requiring the extensive use of professional judgment, including uncertainty expressions, need to be translated accurately (Hellmann, 2010, p.110; Zeff, 2007).

Moreover, among other cultural dimensions suggested by Hofstede (1980), high Power Distance, high Collectivism and Long-Term Orientation[7] are considered to be the most influential dimensions on the societal environment (The Chinese Culture Connection, 1987; Hofstede & Bond, 1988; Hofstede, 2001; Patel, 2006, p.58). Table 1 shows the location of China, Japan and the USA on cultural dimensions of Power Distance, Individualism/Collectivism, and Long-term Orientation and their comparative measures. Because China is a high Power Distance and Long-term Orientated nation, Chinese people accept and expect that power is distributed unequally, and accept power relations that are more autocratic and paternalistic (Hofstede, 1980; Hofstede, 2010, p.243). In accounting context, this culture characteristic may cause the lower level of application of professional judgment in adopting and implementing accounting standards. In addition, because China is a Collectivistic nation, most Chinese prefer collective decision-making which tend to be taken by consensus among group members rather than individual decisions (Xiao, 2004, p.213). As such, the application of independent professional judgment may be less preferred in China than in Anglo-American countries, such as the UK and the USA (Gray, 1988).

Hofstede's cultural dimensions are criticized to be too simplistic for the following reasons. Firstly, because Hofstede's data were based on a single U.S. multinational company, namely,

7) Power Distance refers to the extent to which hierarchy and unequal power distribution in institutions and organizations are accepted. Collectivism refers to a preference for a tightly knit social fabric than a loosely knit social fabric. Long Term Orientation stands for the "fostering of virtues oriented towards future rewards, in particular perseverance and thrift" (Hofstede, 2001, p.359).

Table1: The Scores of Cultural Dimensions

	Power Distance		Individualism/Collectivism		Long-Term Orientation	
	Index	Rank	Index	Rank	Index	Rank
China	80	12-14H	20	55-63L	118	4H
Japan	54	49-50M	46	35-37M	88	3H
The USA	40	59-61L	91	1H	29	67-71L

Source: Hofstede et al., 2010, pp.57-59, 95-97,255-258.
Note: H: top third, M: medium third, L: bottom third
The ranking of Power Distance and Individualism/Collectivism are out of 76 countries, while the ranking of Long Term Orientation is out of 93 countries.

IBM, they might not be representatives of cultural dimensions within various countries. Secondly, because Hofstede's data used IBM non-managerial employees as subjects, the data might not represent cultural dimensions of the broader populations of different occupations and job titles (Spector et al., 2001). Therefore, it is necessary to expand Hofstede's cultural dimensions by taking account of other important national cultural features (Stedham et al., 2008, p.537). These criticisms lead the following argument that it is needed to pay attention to the influence of other two important Chinese cultural features, namely Confucianism and *guanxi* on accounting practices in China (Stedham et al., 2008, p.537).

The teachings of Confucius have played an important role in forming behaviors and the thinking of Chinese (Hofstede & Bond, 1988; Hofstede, 2001). Specifically, the stability of society has been achieved by unequal relationships between people, called "filial piety (*xiao*)" and "loyalty (*zhong*)". The emphasis on filial piety or loyalty to the state, family and friends in Confucianism give these bodies privileged access to information and resources, thus can lead to an accounting system with attributes of secrecy in disclosure. Especially, Confucianism emphasizes the importance of close family relationship which may engender more of an emphasis on family enterprises than publicly-held companies. Family enterprises are not inclined to provide disclosure of their operating performance and financial position to external stakeholders. Moreover, the avoidance of conflict is also valued as a cardinal virtue, called "humaneness (*ren*)". Confucianism suggested a "middle way" to resolve conflict, called "moderation (*zhongyong*)", which refers to a tradeoff between excessive and insufficient risk avoidance. The "moderation (*zhongyong*)" doctrine may lead to 'income smoothing' which involves an attempt to avoid greater and more extensive disclosures about risk in financial reports. Other virtue ethics such as thrift called "frugal (*jian*)", requiring not spending money more than necessary, which lead to prudent and conservative virtues (Hofstede and Bond, 1988; Hofstede, 2001; Bloom and Solotko, 2003).

In addition to Confucianism, *guanxi* has played an important role in forming Chinese business and culture. *Guanxi* generally refers to personal relationships or social connections based on mutual obligations and benefits exchanges, which includes close family members, distant relatives, friends, schoolfellows, colleagues, and business partners (Yang, 1994; Dunning & Kim, 2007, pp.330-331; Wang, 2007, p.81). *Guanxi* can improve business efficiency by close and reliable relationships among *guanxi* members which can reduce transaction cost, such as negotiation and monitoring cost, and can improve organizational and technological innovation as well as capital flow (Davies, 1995; Yi and Ellis, 2000, p.26; Pye, 2000, p.252). On the other hand, *guanxi* is recognized to encourage nepotism, corruption, rent-seeking and bribery, because scarce resources are allocated to a minority through the clandestine personal relationship rather than open market competition, which seriously undermine the effectiveness and democracy of economic and political processes (Wu, 2001; Hsu, 2005; Fan, 2002, p.377; Shin et al., 2007, p.167). Moreover, lobbying groups such as large SOEs generally use their relationship with government officials to influence over policy-making to secure a favorable business environment in China (Gao and Tian, 2006, p.78; Zhu, 2009, p.134). The lobbing activities by various *guanxi*-related interests groups are likely to create a complex political environment for policy-making process in China, including policies concerning the adoption of IFRSs. These policies with respect of the adoption of IFRSs are formulated by the Ministry of Finance (MOF) which is a public sector accounting standards setter in China. In addition, the MOF has been strongly influenced by *guanxi* which is likely to diminish the need for financial reporting and public disclosures because actors, such as managers, investors and creditors can exchange private information effectively in a *guanxi* network (Davies, 1995, pp.210-211).

3.2 Organizational Environment: Companies Structure, Source of Financing, Corporate Governance of SOEs

More than 99% of all types of Chinese companies are not capital markets oriented. While the total number of all types of Chinese companies by the end of 2010 was about 6.5 million, the number of listed companies in Shanghai and Shenzhen Stock Exchanges was 2428 in June 2012 (Chinese Statistical Yearbook 2011). Indeed, the majority of all types of Chinese companies have quite limited number of shareholders. In extreme cases, a company is controlled by only one shareholder or several family members. Table 2 provides an overview of the organizational environment in China by summarizing the different types of business organization as of December 2010. Additionally, most companies are small sized with not more than 300 employees and the annual revenue of these companies are less than 20 million Chinese yuan (about U.S. $3.13 million).

The fact that the majority of Chinese companies are not capital market oriented is closely related to the financing methods of Chinese companies. Although China has the sixth largest exchange in the world in terms of market capitalization by the end of 2011, namely the Shanghai Stock Exchange (World Federation of Exchange, 2011)[8], it is still difficult for most Chinese

Table 2: Types of business organization in China

Unit: thousand

Type	Total
Sole proprietorships	4683.9
State-owned Enterprises	153.8
Collective-owned Enterprises	192.3
Limited Liability Corporations	773.3
Stock Corporations Ltd. (2428 are listed in capital markets)	119.2
Other	595.2
Total	6517.7

Source: Chinese Statistical Yearbook 2011.

Note: State-owned Enterprises in this table only include the SOEs that are 100% owned by the state. Collective-owned Enterprises refers to the enterprises that are owned by a group but the quantitative number of ownership of individuals in this group is not defined.

companies to raise funds in capital markets through issuing stocks publicly and having their stocks listed and traded on stock markets. This is mainly caused by the fact that the Chinese government strictly controls the issuance of stocks and only allows a certain number of new shares to be publicly offered and exchanged on stock markets (Tian, 2011, p.83). To protect investors, the regulatory body of capital markets in China, namely the Chinese Securities Regulatory Commission (CSRC) is likely to give priority of listing to the companies which have large-scale assets and low liability to asset ratio because the CSRC considers these companies are less likely to fall into financial troubles (Hu, 2011, p.60).

Moreover, the SOEs and private companies whose managers have political party membership have larger lobbying power, therefore, these companies are more easily to obtain approval for listing from the CSRC (Hu, 2011, p.60; Hu and Liu, 2011). As such, the intervention of the CSRC in the issuance of stocks has resulted in rent-seeking, inefficiency and bureaucracy which considerably increase the cost of publicly issuing stocks for Chinese companies (Shi and Zeng, 2012, p.5). Accordingly, the small and medium sized companies which are relatively at economic and political disadvantage can hardly raise funds through publicly issuing stocks. In addition to stock markets, the corporate bond market in China is undeveloped with extremely small volume[9], which can not meet the financing needs of Chinese companies. In 2006, the corporate bond market provided only 1.4% of the financing needs of Chinese firms (Hale, 2007; Pessarossi and Weill, 2011, p.2). As such, market-financing is not an important source of funds for Chinese companies, most of them are still dependent on bank debt and retained profits for fund-raise

8) The top five capital markets were New York stock exchange, NASDAQ, Tokyo stock exchange, London stock exchange, and Euronext (Europe).

9) The closing balance of corporate bonds up to December 2010 was 173.79 billion Chinese yuan (The People's Bank of China, 2011), while the market capitalization of Chinese capital markets was 26.5 trillion Chinese yuan at the same time.

(Biondi and Zhong, 2007, p.696).

Given the predominance of bank credit and retained profits as sources of funding, the Chinese financing system fits Nobes' (1998) definition of a 'credit-insider' system, in which no strong pressure exists to publish detailed financial information to investors compared to Anglo-American countries, such as the USA. That can be mainly attributed to two factors. Firstly, banks as main providers of funds, especially state-owned banks do not mainly base their lending decisions to SOEs on financial reporting. That is because SOEs which can be subsidized by the government when they face financial distress have low bankruptcy risk, accordingly, banks are less likely to effectively monitor SOEs' default risk using financial reporting (Chen et al., 2010, pp. 980-984). Secondly, banks can get access to private information through establishing *guanxi* relationship between bank officers and managers of borrowers (Nobes, 1998, p.166; Nobes and Parker, 2008, pp.31-32; Doupnik & Perera, 2012, p.41; Hellmann, 2010, p.110; Talavera, 2012, p.55; Li et al., 2011, pp.163-165).

Although the number of listed companies in China has grown rapidly in last three decades, from 10 at the end of 1990 to 2428 in June 2012, Chinese capital markets are highly concentrated and illiquid compared to capital markets in Western countries. The high concentration and illiquidity can be largely attributed to the fact that more than half[10] of all listed companies were transformed from SOEs which were previously owned by the state alone, and in the process that SOEs were reorganized to joint-stock corporations and listed on capital markets since 1990s, the Chinese government retained a controlling stake in many of SOEs and the shares held by the Chinese government are untradeable in Shanghai and Shenzhen Stock Exchanges before 2007 (Chen et al., 2006, p.427; Chen et al., 2009, p.7; Aiken et al, 1995, pp.168-169; Biondi et al., 2007, p. 702; Baker et al., 2009, p.110). In the case of these listed SOEs, the Chinese government is deeply involved in the corporate governance, through appointing employees or officials to each SOE to perform as the chairperson of the board[11] and executive officers (Doupnik & Perera, 2012, p.245; Qian, 2001, p.297; Clarke, 2003, p.499; Unger & Chan, 1996). Accordingly, the Chinese government has a privilege to access internal information for their decision-making. As such, external pressures for corporate governance are relatively weak in China, which reduces the pressure to enhance the transparency of financial reporting.

10) Chen et al. (2009) reported that 1,213 SOEs conducted Initially Public Offering (IPO) from December 2000 to June 2006. The number of initially listed SOEs during this period has accounted for more than half of all listed companies. After IPO, the median state ownership in these SOEs is 33.9%.

11) Chairperson of the board in Chinese companies is quite different from that of the USA, because the chairperson of the board in a Chinese company is a full-time executive and wields significant power (Doupnik and Perera, 2012, p.237).

3.3 Professional Environment: CPAs, Accounting Firms, Professional Organization

The Chinese Institute of Certified Public Accountants (CICPA), the MOF and the China Securities Regulatory Commission (CSRC) have contributed to forming professional environment in China. The CICPA was established in 1988 as an independent and self-disciplinary professional organization to supervise its members, individual CPAs and accounting firms. The CICPA is mainly responsible for conducting CPA examinations, managing registration of CPAs and taking disciplinary actions against CPAs and audit firms. However, the CICPA is under the significant influence of the MOF which has the authority to appoint senior officials to be the council members of the CICAP (Doupnik and Perera, 2012, p.241; World Bank, 2009, p.8; Tang, 2000, p.98). In addition to the control of the MOF over the CICPA, the MOF and the CSRC jointly supervise the audit firms which are granted with the qualification of auditing Chinese listed companies. The MOF and the CSRC are responsible for the reviewing and inspecting the quality control review, and enforcing disciplinary actions against CPAs and these audit firms. As such, there is a strong bureaucratic influence to control the self-disciplinary professional organization, namely the CICPA, as well as audit firms in China. Following the code law tradition, there is also a strong governmental influence to enforce financial reporting practices, given that the MOF has sole authority for the setting of accounting standards and deciding the policy of adopting IFRSs. It can be argued that Chinese High Power Distance cultural characteristic which emphasizes supreme political power of the government is a reason for the bureaucratic influence of the MOF and the CSRC on professional environment.

The number of CPAs is another important element of professional environment. Comparison of the number of certified public accountants (CPAs) in relation to population size reveals that the accounting profession in China is relatively small compared to Anglo-American countries, such as the USA. The number of CPAs per one million population in China is about 131 (about 180,000 / 1370 mil.) while the number is 1,087 (342,490/315 mil.) in the USA (CICPA, 2010; MIAC, 2011)[12]. Furthermore, similar to the USA where only 44 percent of all U.S. CPAs work in the audit industry, there are only about 50 percent of all the Chinese CPAs (95,378 CPAs) work in auditing firms to perform auditing, taxation and consulting, (CICPA, 2010; World Bank, 2009, p.9; JICPA, 2010). Because the number of CPAs is often used as a proxy of professional accountants, thereby representing the quality of audit in a country (Saudagaran, 2004, p.10), it is suggested that there is a low quality of audit in China.

However, the low ratio of CPAs in China can largely be attributed to the different CPA examination between China and the USA. For example, the candidates for the CPA title in the USA are required to pass four subjects, and the average passing rate of these four subjects of the

12) These numbers are calculated by author, using data from the Chinese Institute of Certified Public Accountants (CICPA) (2010), and MIAC (2011).

U.S. CPA exam was 45.6 percent[13] in 2010. In contrast, applicants for the Chinese CPA exam are required to pass five subjects before 2009, the average passing rate of these five subjects of the Chinese CPA exam was 14.6 percent[14] in 2008. In the trend of international convergence, to improve the application of judgment of Chinese CPAs in applying IFRSs and IFRSs-based Chinese GAAP, Chinese authorities have reformed the CPA exam in 2009. New Chinese CPA exam requires candidates to pass a dual-stage CPA exam. The first stage exam includes six subjects[15], which is intended to test applicants' amount of knowledge accumulated by rote learning. The average passing rate of these six subjects was 24 percent[16] in 2010. After passed all the six subjects, candidates have to pass the second stage exam including one comprehensive subject, which is intended to test problem-solving skills, the capability to make sound professional judgments and the ability to identity ethical issues in the practice (CICPA, 2009). This suggests that Chinese candidates are required to complete difficult examination compared to the USA, which could be an obstacle to increase the number of Chinese CPAs.

However, it is criticized that the Chinese CPA exam system requires candidates with lower education and practical experience level to get the CPA title than their counterpart in Anglo-American countries. For instance, the American Institute of CPAs (AICPA) requires candidates to complete 150 semester hours of accounting education which not only includes four-year undergraduate program but also includes graduate-level program[17]. Additionally, the International Federation of Accountants (IFAC) requires a minimum of three years practical experience in performing the work of professional accountants (IFAC, 2011, para. 11). In contrast, there is no four-year undergraduate accounting relevant education requirement in the Chinese CPA exam, and the practical experience required to get the CPA title is a period of two years (The Chinese CPA Law, Article 8, 9). The relative lack of education and experience of Chinese CPAs may hinder the application of IFRSs or IFRSs-based Chinese GAAP, which are based on the principles-based approach and requires accountants to exercise professional judgments (The Institute of Chartered Accountants of Scotland, 2010, p.5). Additionally, Chinese culture has also contributed to the relatively low level of professional judgments. As analyzed in the social environment, China has Collectivistic, high Power Distance and Long-term Orientated societal value in which

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13) The passing rate of Auditing and Attestation, Business Environment and Concepts, Financial Accounting and Reporting and Regulation of the U.S. CPA exam in 2011 was 45.6%, 47.1%, 45.6%, 44.2% respectively (AICPA, 2011).

14) The passing rate of Accounting, Auditing, Financial and Cost Management, Economic Law and Taxation Law of the Chinese CPA exam in 2008 was 10.8%, 15.1%, 15.3%, 18.0% and 13.6% respectively (Accounting Yearbook of China, 2009).

15) The six subjects include Accounting, Auditing, Financial and Cost Management, Economic Law, Taxation Law (previous subjects) and Corporate Strategies and Risk Management (the newly added subject).

16) The passing rate of Accounting, Auditing, Financial and Cost Management, Economic Law, Taxation Law and Corporate Strategies and Risk Management of the Chinese CPA exam in 2010 was 26.1%, 26.9%, 27.2%, 22.2%, 20.4% and 25.7% respectively (Accounting Yearbook of China, 2011).

17) See this at http://www.aicpa.org/BECOMEACPA/LICENSURE/REQUIREMENTS/Pages/default.aspx.

accountants are not encouraged to make professional judgments in implementing accounting standards (Xiao, 2004, p.213; The Institute of Chartered Accountants of Scotland, 2010, p.5). As such, it is suggested that Chinese accountants are lack of accumulated experience, past education and cultural background as a basis for making judgments, which forms a significant barrier to effective implementation of IFRSs or IFRSs-based Chinese GAAP (The Institute of Chartered Accountants of Scotland, 2010, p.7).

In the light of international trend of convergence towards IFRSs, to improve judgments of Chinese accountants, the MOF initiated a training program in 2005 to train and educate about 1,000 accounting professionals during the next one decade who can provide accounting services, such as financial reporting preparing, auditing and consulting under both the Chinese GAAP and IFRSs. This program is consistent with Chinese convergence process towards IFRSs, the integration of Chinese economy into the global economy, and the global expansion of Chinese enterprises which finance from foreign capital markets or try to expand their business overseas (Wang, 2010; MOF, 2007).

3.4 Individual Environment: Accounting Standards Setting Body, Lobby Groups

Following the code law tradition, there is a proactive stance of the Chinese government to create and enforce financial reporting practices. Compared with Anglo-American countries where setting authoritative accounting standards is the responsibility of accounting societies or independent bodies established for that purpose, the MOF which is a public sector has sole authority for the setting of accounting standards. Various stakeholders can express views and opinions during the process of establishment and revision of accounting regulations by the MOF. Major stakeholders include public sectors, such as the CSRC, the State Administration of Taxation (SAT, hereinafter) and State-owned Assets Supervision and Administration Commission (SASAC), as well as private sectors, such as large SOEs, accounting firms, stock exchanges, and accounting academics. These lobbying groups express views through having their senior officials or managers being employed as members in the China Accounting Standards Committee (CASC) which was established within the MOF in 1998 and plays a role as a consultative agency to provide advices and suggests for the establishment and revision of the Chinese GAAP.

Because of the influence of various stakeholders, the MOF has not focused on the information needs of investors and creditors in the global capital markets as the IASB did, but follow two objectives in the process of establishing the Chinese GAAP: (1) enhancing the international comparability of financial reporting to integrate the Chinese economy into the global economic system and to increase the attractiveness of Chinese capital markets; and (2) fostering economic development, such as increased production, employment and industrial reorganization (Tsai, 2006; Ezzamel et al., 2007; Biondi and Zhang, 2007; Baker et al., 2010, pp.107-108). As such, the MOF has sough to comply with international standards insofar as those standards do not adversely affect economic development (Baker et al., 2010, p.114). In cases where the MOF concludes that the IASB standards may have an adverse impact upon the economic development in China, such as the extensive application of fair value, the MOF had amended or substituted the IASB standards to avoid introducing 'excess volatility' into earnings and feedback effects on business practices (Penman, 2006, p.33; Biondi and Zhang, 2007, p.698). As such, it was recognized that the MOF establishes the Chinese GAAP through a process of integrating and amending IASB standards (Baker et al., 2010, p.111).

Indeed, the MOF has achieved convergence with IASB standards by issuing a new set of Chinese GAAP in February 2006 which is considered as 'substantial convergence' with IFRSs. Furthermore, as a response to the pressure to adopt IFRSs by the IASB, G20 and the Financial Stability Board (FSB), the MOF has committed to achieve full convergence with IFRSs until 2011 by eliminating "the few"[18] differences existing between the Chinese GAAP and IFRSs in the *Roadmap for Continuing and Full Convergence of the Chinese Accounting Standards for Business Enterprises with the International Financial Reporting Standards (Exposure Draft)* (Roadmap ED, hereafter) issued by the MOF on September 2, 2009.

The reasons for the MOF's decision to international convergence towards IFRSs can be summarized as follows by reviewing the opinions of top officials of the MOF. Firstly, convergence can facilitate the integration of Chinese economy into global economy (Yang[19] et al., 2011, p.9). Secondly, convergence can improve the quality of financial reporting, thus facilitate decision making of investors in capital markets (Yang et al, 2011, p.10; Liu,[20] 2010, p.56). Thirdly, convergence can reduce the cost of financing in overseas capital markets of Chinese companies (Yang et al, 2011, p.10). Fourthly, convergence can reduce the competence gap between local accounting firms and the Big 4, accordingly, promote the business expansion of local accounting firms not only in Chinese mainland but around the world (Yang et al., 2011, p. 10). From above, it can be concluded that the benefits of convergence related with the international financing and business expansion, as well as the development of capital markets are the main considerations of Chinese policy-makers when they decide to converge the Chinese GAAP towards IFRSs.

However, the MOF rejected to revise relevant standards in the Chinese GAAP to comply with the revision of IFRSs[21] after recent financial crisis, and the MOF has emphasized that it will not

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18) The MOF has claimed that the Chinese GAAP has realized 'substantial convergence' with IFRSs, excluding differences related with accounting for business combination and the reversal of impairment. However, Biondi and Zhang (2007) provide evidences that substantial divergences between Chinese standards and IASB standards exists in practice.

19) Yang, M. is the Director General of Accounting Department under the MOF.

20) Liu, Y. is the Director-general of Enterprises Department under the MOF.

adopt IFRSs as national standards in China (Liu, 2011). The reason for the MOF's opposition to direct adoption of IFRSs can be summarized as follows. Firstly, new revision of IFRSs has extended the range of application of fair value, which may reduce the reliability of financial reporting. Financial reports prepared according with the Chinese GAAP can provide relatively reliable financial information to facilitate the decision-making of stakeholders of enterprises, and can improve macroeconomic policy-making of the state (Liu, 2011, pp.10-11). Indeed, the government is also an important user of financial information in China. Secondly, the Chinese GAAP can coordinate the interests among stakeholders. For example, using the Chinese GAAP, creditors can easily calculate the financial ratios related with solvency, profitability and efficiency of enterprises (Liu, 2011), and net income is used as the basis for calculating the income available for dividend[22). Thirdly, the prohibition of recycling other comprehensive income to net income may influence the calculation of net income. To avoid volatility caused by fair value, more than 90% of financial assets were classified as available-for-sale and held-to-maturity securities (Liu, 2010, p.2). Although available-for-sale securities were measured at market value, the variance of such items was displayed in the net asset section on the balance sheet, gains or losses caused by such items were recognized as net income only after disposition. As such, in order to calculate net income and avoid double counting comprehensive income, the recycling procedure is indispensable. Fourthly, adoption of IFRSs may result in huge amount of current losses for Chinese enterprises. For example, the elimination of the percentage-of-completion method in revenue reorganization may result in huge current losses for enterprises with long-term construction contracts, and disrupt the determination of revenue, cost and profit (Liu, 2011, p.12).

Overall, the MOF's policy to converge with IFRSs reflects the focuses on the "global context" featured by newly established Chinese societal, organizational, and professional environments such as the change in industrial structures from manufacturing industries to service industries, the change of financing method from bank debt to direct financing, and the international expansion of Chinese companies. In contrast, the MOF's rejection of adopting IFRSs highlights the "local context" featured by traditional Chinese societal, organizational, and professional environment such as specific design of business transactions and the Chinese government's macroeconomic control.

3.5 Accounting Environment: Adoption and Implementation of Fair Value

In 2006, the MOF promulgated a new set of Chinese GAAP that is supposed to conform to

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21) Such as the revision about IFRS 9: Financial Instruments, IFRS 13: Fair Value Measurement, IAS 1: Presentation of Financial Statements, IAS 17: Leases, IAS 18: Revenue and IFRS 4, Insurance Contracts.

22) According to the Company Law of China, the income available for dividend is calculated as the amount that net income minus 10 percent of net income as a company's 'statutory common reserve' and optionally deducting 'discretionary common reserve' from net income.

IFRSs. With the issue of this new set of Chinese GAAP, the difference of financial statements prepared under the Chinese GAAP and IFRSs would be significantly eliminated. Thus Sir David Tweedie, the former Chairman of IASB stated that “the adoption of the new Chinese accounting standards system brings about substantial convergence between Chinese standards and International Financial Reporting Standards” (IASB, 2006). Given that the Chinese GAAP are substantially converged with IFRSs, in 2007 and 2008 respectively, the Hong Kong Institute of Certified Public Accountants (HKICPA)[23] and the European Commission (EC) suggested that Chinese GAAP is equivalent to IFRSs which was adopted by Hong Kong and by the European Union (EU) respectively (CASC & HKICPA, 2007;EC, 2008).

Although the Chinese GAAP is considered ‘substantial convergence’ with IFRSs and reached equivalence with IFRSs adopted by the HKICPA and the EU (CASC & HKICPA, 2007;EC, 2008), there are still essential divergences between accounting standards and practices in China and in Anglo-American countries (Biondi and Zhang, 2007; Baker et al., 2010, p. 108). One of the major differences is the distinct extent of the application of fair value (Peng and Bewley, 2010). The new Chinese GAAP firstly introduced fair value measurement to determine a broad extent of assets and liabilities in China.[24] However, the historical cost measurement is still preferable and the application of fair value measurement is limited to certain cases. According to the *ASBE-Basic Standard*, which is the conceptual framework in China, measurement of accounting elements generally should be based on the historical cost, and using of present value or fair value to measure accounting elements should only in the case that the amount of accounting elements can be reliably measured (Article 43). Moreover, compared to IFRSs in which fair value measurement is more generally adopted, in the Chinese GAAP, fair value measurement is limited to a smaller extent. For example, ‘investment property’ or ‘biological assets’ (the latter being applied to agriculture) permitted fair value only under certain circumstances, and the historical cost basis remains the benchmark approach. Additionally, contrary to IAS 16 and IAS 38, the Chinese standards for ‘fixed assets’ and ‘intangible assets’ do not allow the revaluation model that better fits the fair value approach by valuating assets at current values. As such, the application of fair value has been constrained in a limited area, and the impact of fair value approach has been materially reduced (Peng et al., 2008; Biondi and Zhang, 2007, p.705). Generally speaking,

23) The Hong Kong Institute of Certified Public Accountants is the accounting standards setter in Hong Kong, and has wide-ranging responsibilities, including assuring the quality of entry into the profession and promulgating financial reporting, auditing and ethical standards in Hong Kong.

24) The fair value was initially introduced into Chinese GAAP in 1998 for valuating non-monetary assets or stock ownership paid and accepted as consideration in debt restructurings. After that, fair value also used as a measurement approach in the non-monetary transactions standard in 1999. However, because debt restructuring and non-monetary transactions have been used as tools for earnings manipulation in China, the MOF decided to revise both standards in 2001, withdrawing fair value measurement (Feng, 2002; Jiang et al., 2008; Peng and Bewley, 2010, p.997).

the static perspective (market reference) mainly and increasingly characterizes IFRSs, while the Chinese GAAP appears to be more based on the dynamic perspective (historical cost reference) (Biondi and Zhang, 2007).

The difference of the extent of application of fair value between the Chinese GAAP and IFRSs is based on the following accounting ecology elements. Firstly, Chinese policy-makers and standard-setting body, such as the MOF follow two objectives including fulfilling information needs of capital markets as well as fostering economic development (Baker et al., 2010, p.107). Accordingly, the MOF seeks to comply with IFRSs only if those standards do not adversely affect economic development. For example, the Chinese standards setter's decision to authorize the pooling of interests method reflects the context of large scale industrial reorganization taking place in China, because the pooling of interests method allows greater flexibility then the purchase method to achieve industrial reorganization without resorting to fair value measures that are often unreliable (Xu and Uddin, 2008; Biondi and Zhang, 2007; Baker et al., 2010, p.114). Secondly, fair value may be infeasible and unreliable in China where a less developed market economy and less advanced pricing techniques make reliable fair price inputs for non-financial instruments much hard to obtain (Peng and Bewley, 2010, p.993).

In sum, accounting standards form an integral part of the regulation of the economic system in China, accounting numbers are used not only for investor and creditor decision making in capital markets, but also for many economic purposes and activities (Baker et al., 2010, p.116). As such, difference between the Chinese GAAP and IFRSs is embedded in the particular Chinese accounting environment which it is unlikely change quickly enough to make fair value feasible in the near term. Moreover, Chinese accounting regulator, namely the MOF claims that convergence is a multilateral or bilateral interaction among countries and parties involved, not a one-way exercise in which national GAAPs approach to IFRSs (Yang et al., 2011, p.10). The position of the MOF in global convergence of accounting standards implies that the IASB should take emerging economies' realities into account in developing IFRSs in order to achieve full convergence.

4. Analysis and Discussion

4.1 Endorsement

Unlike the IASB and the FASB, the Chinese Standard-setting body, namely the MOF is a public sector and the accounting standards issued by the MOF have legal backing in China. Thus, accounting standards prepared by the MOF are simply used as issued and do not need to be endorsed by other authoritative institutions or the legislator. However, the MOF refuses to directly adopt IFRSs. In contrast, the MOF insists to establish Chinese accounting standards by integrating IFRSs. Accordingly, IFRSs are substantially endorsed by the MOF through a process of amending and excluding some regulations of IFRSs (Biondi and Zhang, 2007; Baker et al., 2010, p.111). As such, the endorsement procedure of IFRSs in China results in difference between "IFRSs as issued by the IASB" and "IFRSs as endorsed by the MOF". A senior official of MOF, Liu, Y. (2011), points out the possibility and reasons for exclusion of IFRSs as follows:

> The reason why China did not directly adopt IFRSs is because that the major IASB's revision of IFRSs concerning financial instruments, fair value measurement, revenue and so on after the financial crisis failed to absorb the views of Chinese authorities, such as the MOF and the CASC. The revisions of IFRSs, such as issues concerning the other comprehensive income and impairment in *Financial Instrument* and the issues related with *Presentation of Financial Statements* are impracticable in Chinese context and will significantly influence financial reporting of Chinese companies.

For example, Liu, Y. (2011) points out some accounting standards, which may modify or exclude some regulations of IFRSs because of the superiority of Chinese GAAP to IFRSs. These standards include: (1) Business combination: the Chinese GAAP requires the pooling of interests method to be applied for business combination involving entities under common control, while IFRSs only allows the application of the purchase method for all kinds of business combination (Biondi and Zhang, 2007; Baker et al., 2010; Liu, 2011), (2) Recycling: the Chinese GAAP requires recycling from unrealized income to realized income to calculate both comprehensive income and net income, while IFRSs does not necessary apply recycling for some items such as financial instruments (Liu, 2011), (3) Fair value: the Chinese GAAP uses historical cost as the principle of measurement and partially introduced fair value, for example, fair value is forbidden for the measurement of biology assets, while IFRSs requires biology assets to be measured using fair value. Clearly, the MOF insists the superiority of the Chinese GAAP to IFRSs from the view point of the Chinese traditional accounting concepts such as allocation principle, realization basis, and conservatism.

Although the MOF has made a commitment to revise the Chinese GAAP and achieve comprehensive convergence with IFRSs until 2011 in *Roadmap for Continuing and Full Convergence of the Chinese Accounting Standards for Business Enterprises with the International Financial Reporting Standards (Exposure Draft)* issued by the MOF in 2009, the MOF insists that consideration of Chinese-specific demands when the IASB establishes and revises IFRSs is a necessary condition for China's adoption of IFRSs (Liu, 2011). Another senior official of MOF, Yang, M. (2011), emphasizes that convergence is a bidirectional process between national GAAP and IFRSs, which not only includes the adoption of IFRSs as national GAAP by each country, but also includes IASB's acceptance of opinions of standard-setting bodies in each country to reflect unique demands of these countries in the process of establishing and revising IFRSs. Moreover, the above cases are consistent with Chinese stakeholders' objections to the IASB, which include (1) extensive focus and application of fair value measurement, (2) discarding the traditional concept of net income, and (3) prohibiting the mechanism of recycling from unrealized income to realized income (Liu, 2011).

4.2 Cost of IFRSs Implementation

It is assumed that the cost of IFRSs implementation is expected to be extremely high in developing and transition economies where the traditional accounting systems were extremely distinct from IFRSs, and there is a lack of necessary infrastructure required to ensure rigorous implementation of IFRSs (Doupnik and Perera, 2012, p.246; Nobes and Parker, 2008, p.65). This is because IFRSs is based on the Anglo-American accounting model which developed in liberal market economy and developed capital markets, additionally, involves extensive application of accountants' professional judgment (Haller and Walton, 2003, p.28; Hellmann, 2010, p.108). China is an economy in transition, its market-based economic systems are still at an early stage of development and accounting professional is relatively weak (Doupnik and Perera, 2012, p.245; ICAS, 2010). As such, large additional costs for the transition of accounting standards towards IFRSs and the establishment of necessary institutions for rigorous implementation of IFRSs will be required. For example, IFRSs recognizes all state-owned enterprises as related parties and requires the application of *Related Party Disclosure*, which will add extremely cost to the disclosure of financial reporting of Chinese enterprises, given that there is a relatively high proportion of state-owned enterprises in China (Ding and Su, 2008, p.476).

Moreover, financial reporting has "economic consequences" which may have detrimental impacts on the decision-making of related stakeholders, such as enterprises, government, investors and creditors (Zeff, 1978, p.56). Because the revision of accounting principles and standards changes performance measures, thereby modifying management incentive and evaluation systems (Tsunogaya, 2011, p.29), potential detrimental economic consequence caused by the transition towards IFRSs is another source for costs of the application of IFRSs. For example, with respect to accounting standard of business combination, compared to the IASB that only allows the acquisition method of accounting for business combinations, the Chinese standards setter also allows the pooling of interests method for business combinations under common control which reflect the context of large scale industrial reorganization taking place in China (Xu and Uddin, 2008, Biondi and Zhang, 2007; Baker et al., 2010, p.108). Compared to the acquisition method, the pooling method can reduce transaction costs of business reorganizations by avoiding the reference to unreliable fair market value measures as well as avoiding huge goodwill recognition and consequently its depreciation as required by IFRSs3 (Pan, 2002; Huang et al., 2004; Busse von Colbe, 2004; Baker et al., 2010, p.108; Biondi and Zhang, 2007. p.711). As such, transition to IFRSs may hinder the process of major-scale industrial reorganization in China which is important for Chinese enterprises to enhance their competitive power, accordingly, may incur detrimental impacts on economic development.

4.3 Interpretation of IFRSs

Chinese lobbying groups, such as the CSRC, the SASAC the SAT, academics, SOEs, accounting firms and stock exchanges not only influence the political process of accounting standards setting, but also serve as a source for the application and interpretation of accounting standards. Indeed, when the new set of Chinese GAAP which is considered substantially converging with IFRSs was firstly applies in listed companies in 2007, the MOF and the CASC, assisted by experts from other regulators, such as the CBRC, the CIRC and the SASAC established a Expert Working Group on ASBE Implementation (Working Group, hereinafter). The Working Group is responsible to give advice on emerging issues concerning implementation of the new set of accounting standards (World Bank, 2009).

Following IFRSs, the new set of Chinese GAAP is also principle-based, and requires the extensive use of professional judgment. Nonconformity use of professional judgment across-nations is likely to create problems in the area of interpretation which may hinder the comparability of financial statements across countries. Specifically, preparers of financial reporting and CPAs may be influenced by their cultural background when making estimations and professional judgments. Because China is a country with High Power Distance, Low Individualism and Long-term Oriented cultural characteristics (Hofstede and Bond, 1988; Hofstede, 2001), Chinese accountants are expected to interpret IFRSs more conservatively (Chand et al., 2009).

The principle-based approach requires sufficient documentation of accounting policies and procedures to enhance accountability of each company. Cheng (2009, p.36) suggests that under the principles-based accounting standards, financial statement preparers and their auditors should prepare sufficient and reliable documentation which can demonstrate a rational decision-making process to reach certain accounting numbers to defend themselves when facing a lawsuit, which is a significant challenge and cost for the implementation of IFRSs or IFRSs-based national GAAP.

4.4 Translation of IFRSs

Translation from English into Mandarin is also though to be part of endorsement procedures. Although there is no Mandarin version of IFRSs, the MOF has integrated IASB standards when established the Chinese GAAP (Biondi and Zhang, 2007; Baker et al., 2010, p.111). Accordingly, the MOF is confronted with problems caused by literal translation of accounting concepts and terms, because there can be associations with terms that have been already applied in the Chinese context and defined differently in the Chinese GAAP. Comparison of similar concepts in Chinese GAAP and IFRSs provides evidence that even some fundamental terms such as 'income,' 'expense' and 'profit' cannot be translated literally. The IASB defines *income* and *expense* as "increases" and "decreases" "in economic benefits" in the *Framework for the Preparation and Presentation of Financial Statements* and defines *profit or loss* as "the total of income less expenses, excluding the components of other comprehensive income" in IAS 1. Obviously, these concepts are defined by the IASB based on asset-liability view. However, in the Chinese GAAP, there is no accurate word to express the IASB's definition of *income* and *expense* as *increases* and *decreases in economic benefits*, because the Chinese understanding of *income (shouru)* and *expense (feiyong)* emphasizes past business activities, actual transactions, allocation of cost and match with realized revenues (MOF, 2006, Article 30, 33, 35). Obviously, these concepts are defined by Chinese standard-setting body based on revenue-expense view. As such, the understanding of *profit* which is derived from *income* and *expense* is also different between the Chinese context and IFRSs, because the *profit* in the Chinese GAAP is defined as follows: "Profit (lirun) is determined by deducting total expenses from total revenues, and plus gains and losses directly recognized in profit of the current periods" (MOF, 2006, Article 37). In other words, *profit (lirun)* in the Chinese context is first calculated by comparing realized revenues and matched expenses during the accounting period, and then the amount of changes in certain items such as unrealized gains on available-for-sale securities and foreign currency translation adjustments are added. This is different from the calculation of *profit or loss* in IFRSs which is calculated initially by changes in net assets at the beginning and end of the accounting period, and then the other comprehensive incomes are deducted (Tsunogaya et al., 2011, p.28).

Importantly, recycling procedures are not necessarily included in calculating *profit* or *loss* defined by the IASB, while certainly included in *profit (lirun)* defined by the Chinese standard-setting body, namely the MOF. Accordingly, the MOF has opposed the prohibition of recycling of unrealized gains on available-for-sale securities recognized in other comprehensive income to realized *profit (lirun)* (Liu, 2011). That is because *profit (lirun)* in Chinese GAAP has been used to provide relevant and reliable information not only for investors' decision-making purpose but also for distribution and taxation purposes, thereby achieving the information providing role and stewardship role of financial reporting (MOF, 2006, Article 4). As such, the possible mistranslation of key concepts such as *income*, *expense* and *profit* and the collision of similar concepts between in Chinese context and in Anglo-American model may cause inconsistent interpretation and application of IFRSs.

Other difficulties in translating IFRSs are reflected in the fact that when MOF translates IFRSs into Mandarin, some technical and linguistic mistakes especially related to probability expressions may be included. These mistakes change the scope and meaning of IFRSs as shown in the following example. IAS 17 paragraph 10 lists criteria for classification of a lease as a finance lease. The English original of paragraph 10 sub-section (c) and (d) are involved with verbal probability expressions:

(c) the lease term is for the major part of the economic life of the asset even if title is not transferred;

(d) at the inception of the lease the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased assets (IFRSs, 2010).

The phrase 'major part' is translated as '*da bufen*' which means 'most part' and may have different understanding from 'major part' in Chinese context. For example, in the Taiwan's Chinese version of IFRSs, which is a translation of English into traditional Chinese, the 'major part' is translated as '*zhuyao bufen*' that may indicate a different scope from '*da bufen*'. In addition, another probability expression 'at least substantially all' is translated as '*jihu xiangdan-gyu*' which means 'almost all' and may cause different interpretation. Moreover, the phrase 'economic life' is translated as '*shiyong shouming*' which means 'usable life'. The IASB defined 'economic life' from two perspectives, the period over which an asset is expected to be economically usable and the number of production of similar units expected to be obtained from the asset. However, the '*shiyong shouming*' only concludes definition concerning with 'the period', and had neglected the limitation of 'economically' usable. As such, the English original version and Mandarin version provide different criteria for the judgment of finance lease.

4.5 Necessity of Consistent Training and Education

IFRSs can be interpreted and applied differently by various country-specific factors such as cultural values and the competence of financial reporting preparers and professional accountants to apply judgments effectively, consistently and fairly (Doupnik and Richter, 2003, 2004; Ball, 2006; Doupnik and Riccio, 2006; Patel, 2006). Indeed, concerns have been expressed over the general level of competence of Chinese accountants in regards to professional judgment. One interview in a report concerning Chinese accounting reform compiled by the ICAS stated that "Accountants in China might not have the experience, education and cultural background to understand how to exercise judgment" (ICAS, 2010, p.10). Importantly, although the auditing profession has difficult examination procedures reflecting all contents of IFRSs-based accounting standards, namely the Chinese GAAP issued in 2006, financial statement preparers in private companies have not completed such an examination as they are not required to be members of any professional body. One interview in the report of ICAS recognizes the inadequacy of judgment skills training and education and pointes out that "The long term goal of upgrading professional levels of Chinese accountants can only be achieved through more training and experience" (ICAS, 2010, p.12).

Indeed, the cost of IFRSs-based accounting standards training and education in China is expected to be extremely higher than Anglo-American countries whose concepts and principles are reflected in IFRSs. Importantly, the understanding of these concepts behind each standard is essential to make appropriate judgment and to interpret and apply IFRSs as intended by IASB (ICAC, 2010, p.10). Accordingly, additional training is necessary for consistent implementation of IFRSs. However, in China, training of IFRSs may be easier for large firms, such as the Big 4, compared to smaller local firms, due to their international and technical resources (ICAC, 2010, p.12). Further, IFRSs educational programs benefit multinational enterprises more than local companies by providing standardized training programs, transferring employees internationally, and conducting performance review more fairly for staff from all around the world (Smith, 2009).

In addition to training and continuing education, the development of specific curricula at universities which explains the concepts and the conceptual model behind IFRSs in a consistent and uniform manner, and cultivates judgment-making skills is an important factor to interpret and apply IFRSs consistently within and across countries. However, in China, only a handful of universities in major cities have developed accounting curriculum and teaching arrangements which can support the appropriate implementation of IFRSs in China. The universities in remote provinces suffer from the scarcity of well-trained teaching staffs that are essential for appropriate interpretation of Anglo-American concepts because students are confronted with the challenges of understanding the accounting environment in Anglo-American countries, thereby need help from well-trained and highly knowledgeable teachers (World Bank, 2009). As such, the training burden will remain principally on the individual firm, maybe a long period of time, until university-level programs include significant IFRSs content to address the shortage of skilled IFRSs users. Interviewees in World Bank's report concerning China's accounting and auditing system notes that in most cases, the individual firm and the auditing firm have to spend substantial amount of time and resources to train newly hired accountants (World Bank, 2009, para. 35). Finally, there is no consistent and uniform educational program in China results in the differences in interpretation and application of IFRSs between in China and Anglo-American countries.

5. Summary and Concluding Remarks

Using the accounting ecology framework developed by Gernon and Wallace (1995) and reviewing the opinions of major officials in the MOF who are responsible for establishing and implementing accounting standards, this paper has examined the main features of the Chinese accounting environment and outline the main reasons why China has adopted a 'convergence approach' rather than a 'direct adoption approach' compared to other countries.

Supporters of international convergence focus on the requirement for high-quality and international comparability of financial reporting, raised by the rapid development of Chinese capital markets and integration into the global economy which underpin Chinese economic development (Biondi and Zhang, 2007, pp.696-670). In Contrast, the fact that financing through capital markets is not paramount to Chinese enterprises, and high concentration and illiquidity of Chinese capital markets results in that the information needs of investors and creditors in capital markets may not be the central focus of the Chinese standards setting body, namely the MOF (Biondi and Zhang, 2007, p.696; Baker et al., 2010, p.111). Different with the FASB and IASB which local the information needs of investors and creditors in global capital market in the core of everything, the MOF follow two objectives: (1) enhancing the international comparability of financial reporting to integrate the Chinese economy into the global economic system and to increase the attractiveness of Chinese capital markets; and (2) fulfilling particular needs of the political economy, such as increased production, employment and industrial reorganization (Tsai, 2006; Ezzamel et al., 2007; Biondi and Zhang, 2007; Baker et al., 2010).

The Chinese cultural tradition originates in the teachings of Confucius which emphasize the avoidance of conflicts. To minimize conflicts, accounting reform in China has been on the basis of cautious approach with a experimental, incremental, and cumulative process. In the context of international convergence, to avoid conflicts between supporters and opponents, the MOF adopted a 'convergence approach' resulting in an accommodation with international standards, but with modifications to suit the Chinese unique contextual factors (Tsai, 2006,2007; Peng and Bewley, 2009).

Although the MOF committed to achieve full convergence between the Chinese GAAP and IFRSs until 2011 under the pressure of the IASB, by eliminating differences existing between the two systems and revising relevant standards in the Chinese GAAP to comply with new revision of IFRSs after the recent financial crisis. However, the MOF also has emphasized the full convergence would be based on the premise that "establishing high-quality global accounting standards should be based not only on economic conditions in developed countries but also on the full account of the circumstances in emerging market economies" (Roadmap ED, part III). As such, the MOF has refused to adopt the IFRSs primly because the establishment and revision of IFRSs have failed to take full account of the specific contextual factors in emerging countries (Liu, 2011, p.14).

Specifically, the MOF opposed extensive focus and application of fair value measurement, because that may cause intolerable volatility of financial statements and unreliability of accounting numbers given the fact that in China a less developed market economy and less advanced pricing techniques make reliable fair price inputs for non-financial instruments much hard to obtain (Liu, 2011, p.11). Additionally, the MOF disapproved the prohibition of the mechanism of recycling from unrealized income to realized income for the reason that the unrealized income accounts for most proportion of assets measured by market value and the realized income is an important number for calculation of income available for dividends and macro-economic policy making (Liu, 2011, p.11). Moreover, the MOF opposed the elimination of the percentage-of-completion method in revenue recognition of long-term construction contracts, because the elimination may lead to confusion over the determination of revenue, cost and profit (Liu, 2011, p.12).

Findings of this paper suggest that certain characteristics of the Chinese accounting environment may cause problems concerning the consistent application of IFRSs and may reduce the comparability of financial reporting with other countries. The main problems that have been identifies include the translation of IFRSs into Mandarin, a lack of qualified accountants, the cultural influence on professional judgments and the extreme cost of implementation of IFRSs. The analysis of this paper shows that it would be problematic to interpret and apply IFRSs consistently without considering the specific contextual factors, including economic development, cultural influence, financial system and related laws.

This paper provides valuable insights into the context in which accounting operates in China. Although each country has a unique accounting environment, it is likely that countries in the trend of global convergence of accounting standards may face similar issues and problems to varying degrees, especially developing and transitional economies. Finally, if China wants to take advantage of being part of the global capital market, it may have to be fair aware the particular Chinese accounting environment characteristics and find ways to facilitate the transformation of accounting environment to be more favorable for the application of IFRSs. Perhaps this would be another area where accounting can be used to achieve economic objectives of a country. The findings of this study may be of interest to international accounting researchers, professional bodies, standard setters, enforcement bodies and multinational corporations not only in China but also in other countries, especially developing and transitional economies which are in the process of convergence towards IFRSs.

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