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ABSTRACT

Since the opening of the Shanghai and Shenzhen Stock Exchange in early 1990s, the economic structure of China has undergone a tremendous change. Although the social structure is still dominated by the socialist public ownership, more and more collective and private sectors appear and take precedence in underpinning the economy in the country. As to the economic structure, China is also going through a transformation from a central planning economy to a socialist market economy.

Social and economic as the factors of environment have a dramatic impact on accounting system. To adapt to the changes in environment, China is adopting International Accounting Standards addressed by the International Accounting Standard Committee so as to provide a guideline to the fast growing stock market. However, the economic environment is far from the one to apply this stock market oriented accounting system.

Key words: China, stock market, accounting system, International Accounting Standards, economic environment

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Xue Ma & Tian Ning

ABBREVIATIONS

- AICPA American Institute of Certified Public Accountants
- ARESE Accounting Regulations for Experimental Share Enterprises
- ASBE Accounting standards for Business Enterprises
- ASC Accounting Society of China
- ASDC Accounting Standards Deliberation Council
- CASC Chinese Accounting Standard Committee
- CEO Chief Executive Official
- CFO Chief Financial Official
- CICPA China Institute of Certified Public Accountants
- CPA Certified Public Accountant
- CSRC China Securities Regulatory Commission
- DAAA Department of Administration of Accounting Affairs
- DITT Deloitte Touche Tohmatsu International
- DM Discussion Memorandum
- FAF Financial Accounting Foundation
- FASB Financial Accounting Standard Board
- GAAP Generally Accepted Accounting Principles
- GDP Gross Domestic Production
- IAS International Accounting Standard
- IASC International Accounting Standard Committee
- IED Inquiring Exposure Draft
- IFAC International Federation of Accountants
- IOSCO International Organization of Securities Commission
- IPO Initial Public Offering

- MOF Ministry of Finance of China
- NYSE New York Stock Exchange
- RAS Revised Accounting Standards of China
- RMB Renminbi (Chinese Currency)
- SEC Securities and Exchange Commission
- SFAC Statements of Financial Accounting Concepts
- SFAS Statements of Financial Accounting Standards
- SOE State Owned Enterprises
- SSAP Statement of Standard Accounting Practice
- SSE Shanghai Stock Exchange
- SZSE Shenzhen Stock Exchange
- TVEs Township and Village Enterprises

CHAPTER 1

RESEARCH DESIGN

1.1 Introduction

An old fable compares China to a sleeping dragon. Maybe this is a pertinent description of China in ancient times. As Chinese, we grow up under the red flag, witnessing the earthshaking transformation in China. Still remembering when we were young, almost everything in the store needed “piao” in Chinese – a kind of quota bill. If we bought goods in the store, we had to have this quota bill first, together with our money, and then we were able to buy things back home. Because goods were really scarce during those days, it seemed that everything needed this quota bill from groceries to daily necessities. For example, each household had a 3-kilo quota for pork meat per month. Even if you had extra money we were not able to buy anything without these quotas.

More than twenty years have passed, the concept of quota bills sounds ridiculous to the teenagers of today. This generation believes that money is omnipotent. This is true in present day China. Merchandise is abundant in the markets. If one has money, one can buy everything. Every Chinese attributes this change to the economic reform. With the open door policy of Deng Xiaoping (former Chinese leader) at the end of the 1970s, China resorting to its huge potential market, attracted a lot of foreign companies to invest in this market. At the same time, the Chinese government relaxed its policy and encouraged the growth of township and village ownership enterprises, which activated the Chinese market and shook the stability of the state-owned enterprises. The whole of China was bathed in the sunshine of the economic reform. The stock market of China was given a rebirth during this time.

The emergence of the stock market has speeded up the transition from a central planning economy to a market economy in China. The reform in economic structure has resulted in the change of accounting ideology. The old accounting system in China was imported from the previous Soviet Union. It was actually fund-based accounting. The practices of accounting were essentially bookkeeping in nature. And this system mainly served the central-planned economy at that time. However, a market economy and central planning economy are like two poles, one located in the Arctic and another in the Antarctic of the earth. It is palpable that the old accounting system does not fit in this new economic environment.

To adapt to the rapid growth in the stock market, China set a new accounting system after the model of International Accounting Standards (IAS) from International Accounting Standard Committee (IASC). The intention of this current IAS-based accounting system is to cope with the fast development of China's stock market. Nevertheless, accounting is a product of the environment. China takes a product stemmed from some other country's environment to China's specific environment. If this accounting system works in China's specific environment will be our debate point in this paper.

1.2 Purpose

The purpose of this paper is to overview the Chinese current IAS-based accounting and the environment for implementing this system, especially the stock market. Through a study of the Chinese current accounting system and the environment in which it applies to see whether this environment is proper for implementing the accounting system.

1.3 Research issues

China is promulgating its IAS-based accounting in order to accommodate its rapidly developed stock market nationwide lately. Accounting is the product of environment, it is influenced by encircling economic, political,

and social environment in turn. Due to the stock market oriented nature in IAS-based accounting, we relate our research to the economic environment perspective.

The stock market is only one of many economic environmental factors affecting an accounting system. What are the effects of other factors, such as the accounting profession, legal systems, enterprise ownership and so on? Each of these mentioned factors will lead to the following research issues:

- a) Does China's economic environment match its current stock market oriented accounting?
- b) Is the accounting system capable of implementing stock market oriented accounting?

1.4 Methodology

1.4.1. Research Method

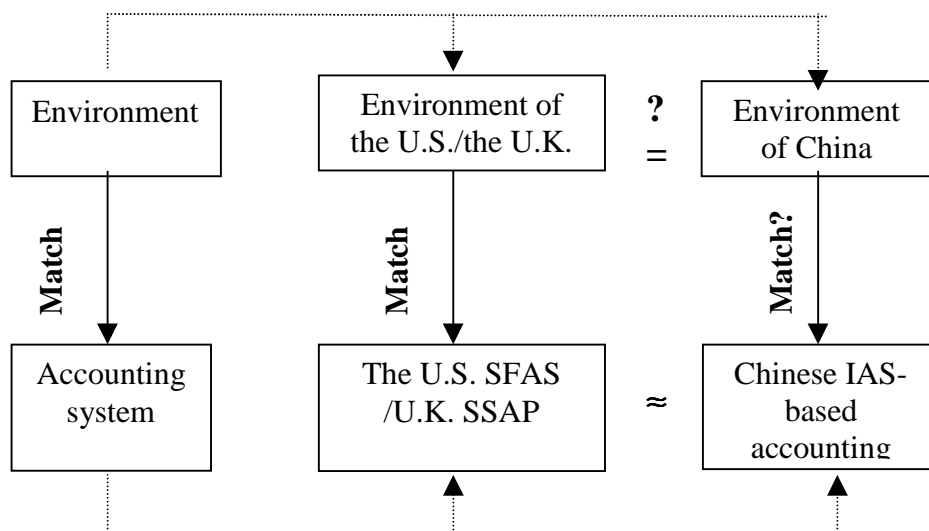
China has promulgated its new IAS-based accounting (ASBE) for a certain time. The purpose of IAS is to establish worldwide accounting standards for securities market so that the corporate reports can be comparable. It has been accepted by many stock exchanges and works well in these markets. We then suppose that the IAS-based accounting should have functioned in Chinese stock market also. But, some problems reveal that there might be some mismatches between accounting system and stock market in China.

The new Chinese accounting standards are reproduced from IAS to a large extent, though China has only promulgated 8 standards and 30 exposure drafts, and IAS has 39 standards. This adoption matches with the current Chinese stock market's needs.

IAS is Anglo-Saxon oriented and many standards have been developed with special reference to the United States and the United Kingdom, which is stock market driven. (Radebaugh and Gray, 1997, p.194). Consequently,

the features of the IASs are close to the Statement of Financial Accounting Standards (SFAS) of the Financial Accounting Standard Board (FASB) of the U.S. and the Statement of Standard Accounting Practice (SSAP) of the U.K. We hereby assume that IAS is almost equivalent to the SFAS or SSAP. On the one hand, IAS does not have an applicable environment, in other words, there is no securities market appointed to use IAS as the only authorized accounting principles in making financial statements. On the other hand, SFAS of FASB and SSAP both well apply to the securities market in the U.S. and the U.K. Due to the analogy between IAS and SFAS and SSAP, we may adopt one of the securities markets of these two countries as a counterpart to China. Our assumption is that if we can verify that the securities markets between the U.S. or the U.K. and China are different, we might explain those mismatches between a securities market and the accounting system in China. This logic can be shown in the following chart:

Figure 1.4.1 The logic framework of our study



Between the U.S. and the U.K. stock markets, we finally chose the U.S. stock market as a counterpart to the Chinese stock market. The reason is as follows: Comparing the securities markets of the U.S. with those of the U.K., the size of the markets of the U.S. is quite larger than the U.K. The

capitalization was USD 13,5 trillion in the U.S. and USD 2.4 trillion in the U.K. in 1998. The U.S. markets represented 49 percent of world capitalization in 1998 and the U.K. accounted for 9 percent only. The trading volume was USD 13.1 trillion in the U.S. and USD 1,2 trillion in the U.K. In the same year, there were 8,450 companies listed in the U.S. markets and 2,399 in the U.K. It is not difficult to say that the U.S. markets are more attractive to investors than those of the U.K.

Comparing the share ownership of these two countries, the U.S. has relatively greater ownership of shares by individuals than the U.K. (Benston, 1976, p.5). Because of the variety of share ownership by individuals, the requirements for information disclosure are greater in the U.S. than in the U.K., which result in a higher degree of transparency.

Also, we found that over the counter markets exist in the U.S., but not in the U.K. However, China has this type of market.

All these findings urged us to choose the U.S. securities markets for they are more attractive, transparent, and thorough. We would absolutely like to draw in a more all-sided market, because in this way, our research would be more persuasive and convincing. Therefore, we selected the U.S. market in our paper rather than the market in the U.K.

As we have known that the U.S. has a highly developed securities market, the SFAS gets along very well with this market. If the accounting standards SFAS or IAS-based accounting standards agreed with this market, they should have worked in other markets, for example, in the securities market of China. This leads us to study what the Chinese stock market looks like. Compared with the U.S., what are the similarities and differences between the Chinese securities market and the market in the U.S.?

In order to answer these questions, we introduced the U.S. securities market. We conducted a comparison of requirements in information

disclosure between these two markets. In the mean time, since the factors of the environment on the accounting system are multi-faceted, for example, the supervisory and regulatory body-the Securities Exchange Commission (SEC) in comparison with the China Securities Regulatory Commission (CSRC), the ownership of enterprise, the legal system, the accounting profession, and so on, the accounting system does not live in a vacuum.

The setting of accounting standards is indispensable from the standard setting bodies. Since we would take the U.S. securities market as a comparison party to China, it is natural and rational that we compared the U.S. accounting standard setting body, the FASB, with the Chinese accounting standard setting body, the MOF, and accounting standard setting processes in these two countries. Another reason for us to adopt the FASB rather than IASC in this comparison is that the IASC is an international union of professional accountancy bodies in 104 countries. A large number of the members with different cultural backgrounds influence the accounting standards setting. As a result, the setting for a standard reflects the preferential interests of a majority of the parties. It represents an opinion from the various countries. This is different from a standard setting within one country, which is determined by the interests of different preparers and users of financial statements within the state. We believe it is better for a comparison to be conducted on a country to country basis.

In practice, “the main aim of international professional standards is to achieve a degree of comparability.” (Radebaugh and Gray, 1997, p.188). To warrant these professional standards to be implemented smoothly, qualified accounting professionals are required. Are the Chinese accounting professionals qualified in implementing a set of advanced accounting system?

Since the Chinese new accounting system is based on the IAS, we suppose that this set of IAS-based accounting is as advanced as the IAS. Adopting

the advanced accounting system is not wrong; however, one could not ignore the fact that it needs to be established on the basis of the same environments. If the environment is different, the accounting system is supposed to change. At the end of the research, we introduced a model of the international classification of accounting systems to search for a right position of China's accounting system in a global range in order for China to draw experience of countries with similar development patterns, and to get better information about the relevance for China of the systems used by other countries.

We included several dimensions when describing and comparing accounting systems and stock markets in our paper. They are regulation, valuation rules, and information disclosure in accounting systems and legal works, enterprise ownership, and accountancy in stock markets. We selected these dimensions by reading literatures.

1.4.2 Research Approach

In our paper, we exploited a descriptive approach. We described some pairs of accounting standards such as International Accounting Standards (IAS) vs. the Accounting Standard for Business Enterprises (ASBE) of China, accounting setting bodies such as the Financial Accounting Standard Board (FASB) vs. the Ministry of Finance (MOF) of China, stock markets such as the U.S. vs. China. We attempted to acquire some similarities and differences through these parallel comparisons so as to learn the current Chinese accounting system and the environment it copes with.

1.4.3 Collection Method

We performed data collecting mainly through a qualitative method. This is because our research subject is limited within topics, such as accounting regulation, including accounting standard setting bodies, accounting standards setting procedures, accounting valuation rules, as well as factors involved in securities markets, such as legal works, and so on.

1.4.4 Data Collection

Because our thesis is a study of literature, we actually only adopted a secondary data collecting method. Secondary data are contained within earlier examinations, existing statistics, literature, and articles. The data of our study were gathered from multiple sources, which are quoted either from Göteborg University Library and its database, or from Beijing National Library of China. Additionally, website information has also been widely explored.

We first looked for all relative topics in relation to our interests, for example, the articles with names or contents in Chinese accounting, Chinese stock market, IAS in China, etc. We read through the material that we garnered either from journals or databases or books to get a better understanding of the appealing events or comments or critiques concerning the Chinese accounting system and stock markets now. In the mean time, we either copied or downloaded or borrowed these correlated articles and documented them in files.

The following step for us was to read these documented articles again and reselected the more pertinent ones to put them together in order to formulate our own opinion. Of course, during this period, we contacted our supervisor and asked him to give us directions.

The process of coming up with something of our own was sometimes frustrating. For quite a long time, we had been grumbling in the darkness and did not know where to go. Other times, we wonder whether we wrote anything relevant within the scope of our intention.

1.4.5 Validity

This paper is a descriptive study of some phenomena that we observed in the economic environment. The factors of the economic environment we

studied are only some indicators to show that the economic environment does not match with the accounting system. They can not really explain the relationship between cause and effect. What we have commented on represents only our personal view and might be right or wrong. We examined the economic environment today which may be inappropriate for implementing an accounting system today, however, as time goes by, these environments will change accordingly. A completely different result of the same research may be reached if done by somebody else in the future.

1.5 Limitation and Scope

According to Radebaugh and Gray (1997, p.47), corporate accounting and information disclosure practices are influenced by a variety of economic, social and political factors, such as, enterprise ownership, the business activities, sources of finance and capital markets, taxation system, accounting profession, accounting education and research, political systems, the social climate, the stage of economics, the rate of inflation, the legal system, and accounting regulation. In our paper, China's securities market will be a main concern of influential factors when testing China's accounting environment. While, some other factors will only be related to, but not focused on.

When describing and assessing China's current IAS-based accounting system, we will focus on analysis of regulation (including standard setting body and standard setting procedure), and valuation rules, and information disclosure aspect; the aspect of the stock market will be cared for in the latter part of the thesis. The former will include a comparison of standard-setting bodies, standard-setting procedures, and standards themselves in a general perspective. We took the FASB and the IAS as examples. The latter will include a comparison of stock markets between China and the U.S., concerning stock market regulation and companies behavior in fact, accounting professionals, etc.

In the comparison between Chinese accounting standards and the IAS, the concerned Chinese accounting standards are not only based on “Accounting Standards for Business Enterprises” which have been formally promulgated, but on “Inquiring Exposure Drafts” which are still in the process of discussion and revision; and the content points quoted are only those we think characteristic and compatible. Therefore, a further detailed comparison is expected in future work.

As mentioned, the paper is a literature study. Therefore, the materials and information are only secondary sources rather than first. An important reason is a limitation on access to practical companies and organizations. For example, when we attempted to contact some Chinese companies and government authorities for interviews, there were always some barriers to hinder our access. They appeared more secretive. We attribute it to the less-opening information disclosure system in China, which is derived from national culture. The phenomenon has also been witnessed by some other researchers (Chen, Gul, Su, 1999), “most investors might not benefit from the disclosures, because their access to information is restricted to summarized financial reports published in securities newspapers and not the complete annual reports. In most cases, the complete annual report is available only to regulatory bodies, government agencies, banks, financial institutions, and securities brokers”. However, we confronted the same problem when trying to get reports directly from the Chinese companies.

1.6 Outline

The whole paper is divided into four parts: research design, accounting systems, stock market, discussion & conclusion.

The first one is about research design. In which, we stated background, purpose of our research. Also in this part, we mainly described the methodology used in conducting our research in order to portray a clear picture to readers of what we are trying to study and how we are doing it. These will lead to the limitation and scope section of the paper.

In the accounting systems part, different accounting systems are described, mainly from regulation, valuation rules, and information disclosure aspects. In this part, in order to have a comprehensive overview and assessment of China's new IAS-based accounting system, we have also compared different accounting systems, especially the IASC, the U.S. Financial Accounting Standard Board (FASB) as counterparts.

In the stock market part, the situation of China's stock market and the U.S. stock will be presented. Since, we'll mainly take China's stock market as environment to assess China's new accounting system, and the U.S. stock market will be as a counterpart to China in order to give a proper evaluation of the stage of development of the Chinese securities market. This, in turn, will formulate our assessment to China's accounting environment. It includes a brief introduction about its history, current situation, the regulations concerning listed companies, etc. Finally, a comparison of stock market between China and the U.S. will be made.

The final part of our thesis is a discussion and a conclusion. In this part, based on the proceeding descriptions and comparisons between different accounting systems and stock markets, we will discuss three questions, which are: is the Chinese securities market an appropriate environment of the IAS-based accounting environment? Is it appropriate for China only to adopt a stock market oriented accounting system? Is the stock market the only factor affecting accounting standard setting? In the conclusion, we will summarize the whole research and give answers to our main research problem, i.e. is China's IAS-based accounting system is appropriate? Finally, some future work concerning our research issues will also be suggested.

CHAPTER 2

ACCOUNTING SYSTEMS

It can apparently be seen that this part is mainly about accounting systems. In order to give a complete view of the Chinese accounting system, the background of China's accounting reform is firstly described. Followed will be a brief introduction of the development of Chinese accounting. Since, the Chinese current accounting system is established and based mainly on drawing experiences of other countries, especially the IASC and the U.S. as references. The different type of accounting systems are then briefly described and discussed to give a complete view and an appropriate assessment of the Chinese accounting system. The accounting systems are described and compared mainly from three dimensions, which are accounting regulation, valuation rule, and information disclosure. Comparisons in the last section between the accounting systems are also made on these three dimensions. In comparison, the U.S. FASB is taken as a counterpart to the Chinese MOF for regulation and information disclosure comparison, while the IASC is taken as a comparison of valuation rules.

2.1 Chinese Accounting

2.1.1 Accounting reform

2.1.1.1 Needs for China's accounting reform

The need for China's accounting reform has been influenced by many factors (Zhang, 1996), including a more diversified and less rigid role of the Chinese government in macro economic management; the increasing complexity of business transactions, such as leasing of machinery and equipment, real estate valuation, business mergers, equity and debt financing, foreign exchange transactions, options and futures trading of commodities and currencies; diversified business ownership in a variety of industries, and the expansion of the securities market. Also, Chinese

companies seeking to raise capital in the international capital markets are faced with the challenge of restating their financial statements to international standards. “Investors demand greater transparency and accountability, China moves to bring the accounts of listed companies closer to international standards” (Leung, 1999). In general, the demand for user-oriented financial information has become readily apparent in China. In order to accommodate the rapidly changing environment, an accounting reform in China becomes an important aspect of the financial and economy reform.

Economic influence

Dramatic increase in the amount of international trade and investment in China has resulted in increase exposure to accounting information produced in other countries. This in turn made the deficiencies in Chinese accounting obvious to international business concerns. Increased international trade and investment requires an accounting system that will meet international expectations and standards (Anonymous, 1998).

Regarding the economy reform aspect, since the state-ownership of the means of production is the essential characteristic of the socialist economy, to invigorate the large and medium-sized state-owned enterprises is the central task of China’s economic endeavor. Consequently, all reform measures taken should contribute to enhancing the vitality of large and medium-sized state-owned enterprises, so as to transform them into the really accountable economic entities with rights to operate, invest and finance autonomously, and responsibilities to assume their profits and losses (Ge, 1992, in Chinese). The economic system reforms especially those related to reform of enterprise operational mechanism, necessarily calls for corresponding reform of accounting.

The demand for both financial accounting and reporting in China is significantly influenced by the extent of the separation between owners and corporate management. In the old times, it was a unified and centrally

planned economy regime that macro-governed the whole of China. The ownership and corporate management were not separated from each other. The State was both owner and general manager of enterprises. Therefore, accounting did not play as important a role in running a business as it does nowadays. But, following the steps of the corporatization of state-owned enterprises, which results in separation between ownership and management of the enterprises, and rapid development of stock market, the domestic and abroad investors other than the state are getting involved in the enterprises business. Care must be taken in both financial reporting and auditing, with which the owners need to assess and evaluate the business performance of the companies reached by the management, and make further economic decisions. For the state, increased emphasis on accounting and auditing arose largely as a result of tax control purposes.

Stock market development

The development of capital markets is a more recent but highly visible aspect of the economic reform in China. To develop alternatives to bank financing, in the early 1980's, Chinese enterprises were given the right to make decisions concerning production, supply, marketing, financing, wages and bonuses, and gradually, they were permitted to retain profits rather than having to pay them over to the relevant government ministry. For the first time, it became possible to set up a company with a share capital (Field, Pendrill, 1998). This policy has been facilitated both by developing the securities market in China as well as listing Chinese companies on international stock exchanges. Thus, a more apparent and reliable accounting and reporting system is a favorite to users of accounting information in the stock market. The old uniformed system, which was based on the centrally planned economy, will not fit the new market any more, and therefore must be got rid of.

Promulgation of disclosure requirements for Chinese listed companies is vested with the China Securities Regulatory Commission (CSRC), which was established in 1992. The CSRC has now assumed the important role of

dealing with accounting and financial reporting issues. It has published a series of regulations relating to public disclosure of information by listed companies. Disclosures in annual reports are mainly outlined in the CSRC's Content and Format of Information Disclosed for Publicly Traded Companies: "The Content and Format of Annual Reports". The regulation has been revised several times since 1994. The most recent revision was made at the end of 1997. The current disclosure regulation requirements are largely comparable to IAS, major areas of disclosure covered by IAS are also covered by the CSRC regulation. As listed companies are of some large business enterprises in China, the CSRC has been confronted with many new accounting and reporting issues. Most of the CSRC's announcements on public disclosure for listed companies have been very influential in the process of setting accounting standards. The concerning discussion will be specifically developed in our later part of "China's stock market".

2.1.1.2 Development of China's accounting system *Evolution*

China has practiced a centrally planned economy for over forty years, and a uniform accounting system has been used to facilitate central planning by various government agencies. One of the main characteristics of the traditional system in China was that both financial accounting and reporting served for taxation purposes. As a result, the tax authority and related government agencies were the principal users of financial information, and business management had little discretion in accounting choices and methods. Moreover, the majority of the accountants did not possess good knowledge of accounting theory and practice. (Zhang, 1996). As China's economic system has moved along the spectrum from a socialist, centrally planned economy, it has been necessary to make major changes to its accounting system, that is a transition from a system of fund accounting to a capitalistic system of accounting. (Field, Pendrill, 1998).

Prior to 1978, China's economy was dominated by state-owned enterprises (SOE) which were essentially production units to fulfill the state's stipulated production quota. The accounting system was imported from the previous Soviet Union. It was rigid and uniform, and primarily assisted the state in economic planning, implementing state economic policies, and controlling the means of production. It was a macro-oriented system providing statistics for economic planning to the different government ministries and tax authorities. The accounting system was fund-based, linked with taxation and filled with strict and detailed rules (Xiang, 1998).

Since 1978, the Chinese economy has undergone a transition from a command control economy to a market-oriented economy. The traditional accounting system with its macro-oriented focus was inadequate in addressing the needs of the growing profit-oriented non-state enterprises and their stakeholders. In addition, the creation of special economic zones in China and the flow of foreign capital into these zones brought considerable pressure for changes in the existing accounting system. (Ajay, Wang, 1995).

The accounting regulations published in the early 1980s, however, allowed foreign-invested enterprises to apply their own accounting systems in financial reporting, and to make necessary adjustments when preparing tax returns. On the contrary, state-owned and collectively owned enterprises have been required to comply with the traditional tax-oriented system. (Zhang, 1996). In 1985, the Ministry of Finance (MOF) promulgated "The Accounting Regulations for Joint Ventures". It provided necessary accounting guidelines for joint ventures operating in China. From an accounting perspective, these regulations for the first time introduced Western accounting practice to the firms operating in China, representing a radical departure from the traditional fund accounting.

Also in 1985, the Accounting Law of China was enacted. Prior to that time, accounting had never been codified in any specific law of China. This law

specified the fundamental functions and legal responsibilities of accounting officers. It covered all state enterprises, state non-business units, government agencies, social organizations, and the armed forces. However, the law itself made few substantive changes to the practice of accounting, merely authorizing the Ministry of Finance to establish a uniform accounting system applicable to all the organizations mentioned above. Despite its limitations, this Accounting Law was the beginning of a fundamental change in China's attitude toward the accounting function from providing aggregate information to improving enterprise performance and finally to becoming an integral part of management itself (Rask, Chu, Gottschang, 1998).

In 1992, the Ministry of Finance enacted two sets of new accounting regulations: "Rules for Enterprises with Foreign Investment" came into effect on July 1, 1992 and "Rules for Experimental Shareholding Corporations" being effective on January 1, 1992 (Xiang, 1998): the first one was to supersede the 1985 Regulation, and applied to all enterprises with foreign investments. These new regulations brought the Chinese accounting for Foreign investment enterprises into close conformity with international accounting practices; the second set of Rules was applicable to all corporatized companies including the listed. These rules for shareholding companies were the first set of rules to incorporate international accounting practices into reporting requirements for China's domestic enterprises.

In 1992, China's Ministry of Finance issued its first accounting standard, "The Accounting Standards for Business Enterprises" (ASBE), and it came into effect on July 1, 1993. These standards in principle apply to all Chinese business enterprises and supersede all previously promulgated accounting regulations. It was the first time that all enterprises of different ownership structures in China were subjected to a unified accounting framework. It also signaled a more close conformity between China's accounting standards with IAS.

In February 1993, the Ministry of Finance of China started a three-year project to formulate detailed accounting standards. The project, funded by the World Bank, employed Eeloitte Touche Tohmatsu International as an international consultant and also involved a number of accounting experts from China. The end result of the project will be an enactment of 30 detailed accounting standards, which are expected to be applicable to all enterprises in China.

2.1.2 Regulation

2.1.2.1 Accounting regulation system

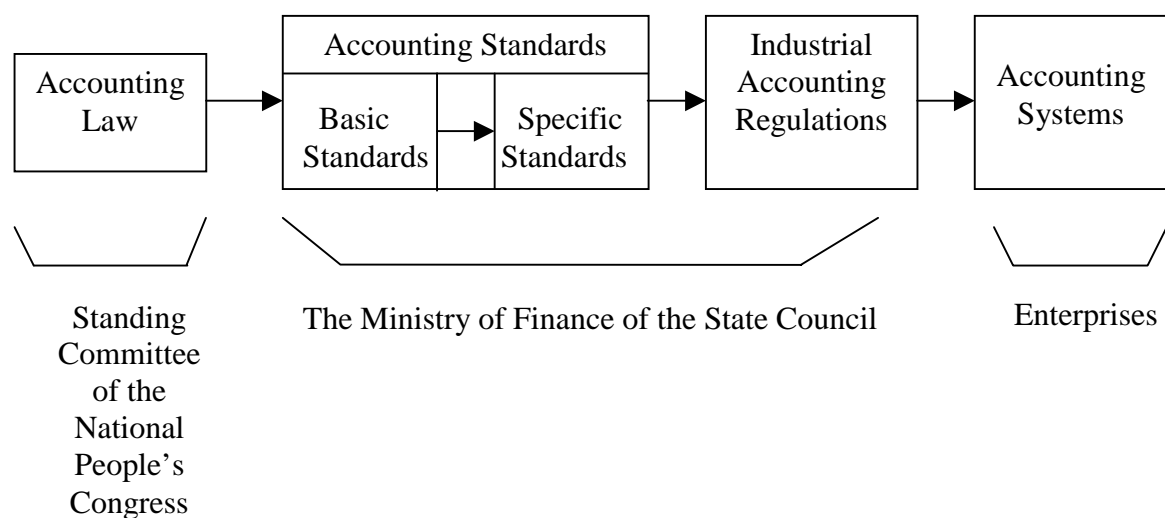
China's accounting standard system includes two levels – the basic accounting standards and the specific accounting standards. The first level mainly gives the basic principles for the recognition, measurement of accounting elements and requirements for the financial reporting. The second level takes the responsibility for regulating all kinds of business transactions, based on the principles set by the first one.

According to Ge (1995, p. 104-106, in Chinese), in China, specific accounting standards and industrial accounting regulations coexist. Actually, they do not repeat each other in their contents, they have different focuses and a minor overlap: the specific accounting standards are set for the accounting activities (events) common to all industries or for special accounting events in certain industries (enterprises), they are the “horizontal” stipulations that are mainly concerned with the recognition, measurement, and disclosure across all sectors and all industries. In a broad sense, they cover only the accounting policies that need to be normalized, and do not deal with the opening, using, and recording (the whole process of recording in the double-entry bookkeeping system) of accounts. Even though, accounting recognition encompasses recording, it limits only to the accounting treatment and information disclosure for events covered by particular specific accounting standards. Specific accounting standards only give some fundamental guidelines, thus, they are unable to reflect the

characteristics of different industries. On the other hand, the industrial regulations are the “vertical” stipulations that specify the chart of accounts that each firm in a particular industry should design, and the way to use these accounts. Financial statements need to be prepared as well as explanations on the preparation and presentation of financial statements. They complement each other, and can be used in combination.

According to the idea of the MOF, the accounting regulation system of China is designed as follows:

Figure 2.1.2.1 The accounting regulation system of China



*Source: Ge Jiashu, 1995, “On the Relationship between Accounting Standards and Regulations”, *Completing and Developing*, (in Chinese), p. 94.*

As the figure of the accounting regulation system of China shows, the starting point of procedure of the Chinese accounting regulation system is the Accounting Law which is enacted by the standing Committee of the National People’s Congress, and is the legal basis of accounting standard regulation. The Ministry of Finance (MOF) of the State Council is the standard setting body, which is responsible for prescribing and issuing

Accounting Standards and Industrial Accounting Regulations. Accounting Standards are issued following a process of “from general to detail”, i.e. from issuing Basic Standards to issuing Specific Standards. Based on the Accounting Standard issued, Industrial Accounting Regulations are promulgated, which aim to solve the problem of accounting information incomparability cross-different industries. Accounting systems of enterprises come last, which could be diversified depending on the enterprises’ characteristics. It is expected that after enforcing a basic standard first, in which agreement on the basic concepts, principles, and methods of financial accounting could be arrived at, through the integration of international conventions and the particular situation of China, the compatibility of financial reporting could be reached to some extent under this order of accounting regulation system.

2.1.2.2 Accounting standard-setting body in China

The economic reforms toward a free market economy have brought about significant changes in the Chinese accounting system. However, the momentum of the old system still exists. Accounting standards continue to be prescribed by the central government (Ajay, Wang, 1995). The Department of Administration of Accounting Affairs (DAAA) within the Ministry of Finance has full responsibility for administering accounting activities. It is responsible for formulating, issuing, and administering accounting regulations in China.

It is a tradition that China’s accounting standard is set and promulgated by the accounting department of the MOF. However, in order to secure the quality of the issued accounting standards, opinions from various parties are taken into consideration as the MOF stipulates. It has already set up an expert group for accounting standards consulting, consisting of both domestic and foreign professionals. Further, on October 12th 1998, the MOF established the Chinese Accounting Standard Committee (CASC). “CASC’s responsibility is: to provide consulting for a general plan and scheme structure of accounting standards, as well as for setting up a

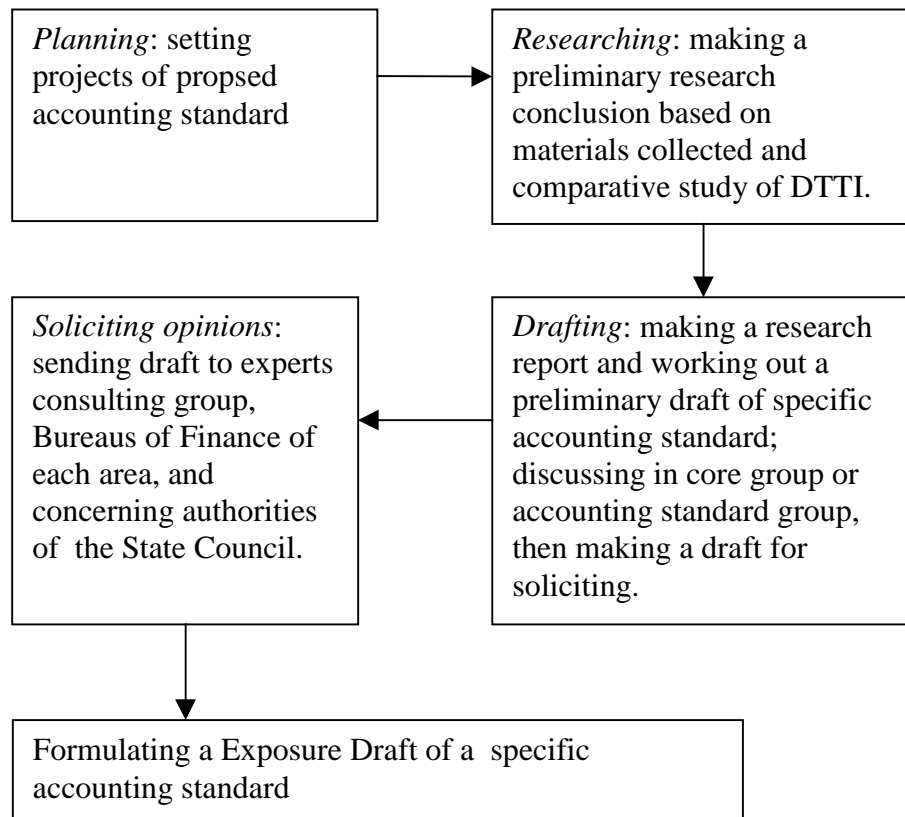
preliminary plan for accounting standard-setting; provide consulting for choices of accounting policies; provide consulting for implementation of accounting standards and to give feedback of concerning information”. (Qu, 1999, p. 15). Members of the CASC are from governmental authorities, academic areas, professional of CPA, Chinese Securities Regulatory Commission (CSRC), and enterprises.

It is undeniable that the MOF has made some efforts in developing the China’s accounting standards-setting process. But, in our opinions, in this process something seems to be missing. The information concerning this standards-setting body has not been further disclosed, such as, list of board members; how does it works; if there are any places for representing those public shareholders who are either from domestic or abroad areas; and information about creditors, especially the national banks that are still acting crucially in the state-owned enterprises? To what extent are the interests of these parties taken into the consideration, etc.?

2.1.2.3 Accounting standard-setting procedure in China

A scientific and reasonable due process is the key to ensure the quality of accounting standards (Lu, 1995, p. 35. In Chinese). The Chinese MOF made investigations and absorbed opinions that are widely in practice, and studied the cumulative successful experience and practice of developing accounting standards by the IASC and other countries. After widely discussing and asking for opinions, the due process of Chinese accounting standards was decided as follows: planning, researching, drafting, exposing, soliciting opinions. The standard-setting procedure in China can be portrayed in following chart:

Figure 2.1.2.3 Accounting standard-setting procedure in China



Notes:

DTTI: Deloitte Touche Tohmatsu International

Consulting group: consisting of 10 domestic experts and DTTI;

Core group: consisting of leaders of Accounting Department of the MOF;

Draft groups: formed based on each bureaus of Accounting Department of the MOF (Liu, 1996, p.273 and 291).

Source: based on information provided by Accounting Department of Ministry of Finance, 1994, *General Illustration of Prescribing the Specific Accounting Standards – Supplemental regulations and explanations of accounting regulations (1)* (in Chinese), p.313.

The figure 2.1.2.3 reveals that standard-setting procedures are divided into four stages: planning, researching, drafting, and soliciting opinions. Which are described by the MOF as follows:

Stage 1. *Planning*: to raise and determine annual projects concerning proposed specific accounting standards, after reporting to and approved by the Ministry leaders, to assign and allocate it to a specific draft group and draft persons, and to decide on a time period for each project.

Stage 2. *Researching*: draft persons need to broadly collect and study domestic and foreign references and literature, to get knowledge of those practices, and to draw a preliminary conclusion. In the process, the expert consulting group of Deloitte Touche Tohmatsu International (DTTI) mainly needs to make a comparative study of accounting standards between main the countries and regions as well as the IAS, and to submit the study reports as reference for the draft persons.

Stage 3. *Drafting*: based on the sources and comparative study reports of DTTI, the draft persons further summarize the research accomplishments, and make research reports, as well as comprehensively expound and prove issues involved in drafting accounting standard proposals. Then, they make a preliminary draft of a specific accounting standard, which will form a draft for discussion after discussion within the draft group.

After the discussion draft is finished, it will be discussed within a core group or accounting standard group. Their revising opinions and suggestions will then be raised. The draft persons work out a draft for soliciting opinions, and report to the Department leaders.

Stage 4. *Soliciting opinions*: after approval by the Ministry leaders, opinions concerning the draft of specific accounting standards will be solicited. First, the opinions will be solicited within the domestic experts consulting group; then the draft will be sent to Bureaus of

Finance of each province, of autonomous regions, of direct-jurisdiction cities, and of planned additionally listed cities, as well as to concerning charging authorities of State Council, for soliciting opinions of theirs and their charged areas. If necessary, ways, such as seminars can also be applied for opinion soliciting.

The draft persons summarize all the opinions solicited, propose a summarized report of opinions solicited to the core group for a discussion. According to the opinions and suggestions of the core group, the draft persons revise the draft. The revised draft will form an exposure draft of a specific accounting standard after approval by the Department leaders. (Accounting Department of the MOF, 1994, p. 313).

2.1.2.4 Chinese approaches to standard-setting in China

Qu (1999, p. 24) says, “an accounting standard system should be a comparatively stable, a continuously changing, and a gradually optimized integration of theories, methodologies, and procedures”. As noted, just since 1993, the ASBE promulgated China has established its new stock market oriented accounting system for the whole country. Therefore, the Chinese accounting system is still in its rudimentary stage. It needs further improvement and development. There have always been some discussions regarding standard setting in China from various interested parties of the society. The questions include: which department should be authorized as a standard setting body? What does this body look like? How should a standard setting process be conducted? Who should be involved in prescribing accounting standards, etc? In the following sections, we will show opinions of some parties concerning this area.

How do Chinese listing companies look upon the accounting standard setting in China?

In an investigation (Qu, Chen, 1998), a questionnaire about China’s standard-setting body and setting process is responded by financial

directors of 30 listing companies in Shanghai and Shenzhen stock exchanges. The result shows: 1) 60% of the companies agree that the Accounting Department of the MOF is to be an accounting standard-setting body in China; 2) 53% of the companies agree on current accounting standard setting procedure, i.e. accounting standards are drafted by the MOF, after soliciting opinions of domestic experts consulting group, Bureaus of Finance of each areas, and concerned authorities of the State Council, the standards will then be promulgated by the MOF; 3) 66.7% *disagree* that accounting standards are prescribed only by governmental officials. (It may confuse readers more or less if this point is compared with the first one, which relates to the standard setting body. As we interpreted that the respondents disagree that there are only governmental officials involved in the standard setting procedure, excluding other interested parties); 4) Most companies prefer China's accounting standards to conform to the IAS as much as possible based on international conventions.

One may get some clues from the above investigation concerning questions of how China's standard setting should be seen in the eyes of listed companies. First, since it is the Accounting Department of the MOF that is traditionally responsible for prescribing accounting regulations, and the private accounting organization in China is not mature, companies can accept that the MOF is in charge of the accounting standard prescription. Second, during the accounting standard-setting process, various opinions need to be broadly solicited, especially the general accountants of large companies, and CPAs with higher qualification and experiences. Accounting standard-setting will then be led by the MOF, and with broad participation of very diverse groups of the society. Finally, adopting IAS-based accounting standards in China is generally accepted by most Chinese listing companies.

How do Chinese professionals look upon the accounting standard setting in China?

Accounting standard setting in China has also been a hot topic in the academic area. Various opinions and suggestions have been raised and discussed. A main point is that China should develop its own accounting system in accordance with its special social-economy environment, simultaneously consider the international conventions, and make it more internationalized and harmonized.

Some scholar (Ge, 1992) thinks, that since China is a socialist country where public ownership plays a dominant role and publicly owned enterprises are the pillar of the national economy, socialist accounting must be subject to the unified administration by the government. One should, therefore, take China's social and economic characteristics into consideration in setting China's accounting standards. The MOF should be in charge of the development of accounting standards. Specifically, the Department of Administration of Accounting Affairs (DAAA) under the MOF should play a major role in standard-setting.

With regard to which kind of standard-setting body should be established in China, there are several opinions beyond the Chinese accounting forum. A strongly supported one is to establish an "Accounting Standards Deliberation Council" (ASDC), which follows the Japanese model - the Business Accounting Deliberation Council under the leadership of and as the consultative body of the Ministry of Finance. There are at least two main approaches to organize such a council (Ge, 1992, p.41):

One is to make the ASDC as a consultative body for the MOF, providing consulting service concerning the development of accounting standards. Meaning, its deliberation opinions on accounting standards will serve only as references for the DAAA in further modification and perfection of accounting standards. Its members will consist of experts and scholars from

fields of accounting, auditing, taxation, finance, banking, the administrative bureau of publicly owned assets, as well as business enterprises.

Another approach is to vest this council with deliberative authority over accounting standards. Under this approach, the accounting standards drafted by the DAAA must first be evaluated by the ASDC before they are approved by the MOF. In this way, ASDC must possess a relatively high degree of authority. Thus, through the ASDC, extensive opinions of the experts and representatives from various fields will be heard and used, thereby improving the quality of accounting standards.

2.1.3 Valuation rules

2.1.3.1 The basic accounting standards of China - Accounting Standards for Business Enterprises (ASBE)

The system of China Accounting Standards consists of a basic standard, entitled Accounting Standards for Business Enterprises (ASBE), and a series of standards on specific accounting matters (the “Specific Standards”), which are formulated in accordance with the ASBE. On November 30th 1992, granted by the State Council, the MOF promulgated Accounting Standards for Business Enterprises, which were effective on July 1st 1993. They prescribed the accounting assumptions and general principles of accounting, the accounting elements and the general requirements for the preparation, as well as a presentation of financial statements. In the following sections, we will describe both briefly:

The ASBE consists of ten chapters, which in turn are divided into 66 articles. According to the MOF (1999, p. 59-74), the structure of the ASBE can be portrayed as follows:

Ch.1. *General provisions* (Art.1-9): stipulating some premises and requirements of accounting, including: objectives, basic accounting assumptions.

Ch.2. *General principles* (Art.10-21): mainly describing accounting principles which are consistent with the internationally accepted accounting principles, including: consistency, going concern basis, accrual basis, matching, etc.

Ch.3.–Ch.8. *About accounting elements* (Art.22-56): prescribing the basis of definition, recognition, and estimation of the accounting elements, including: Assets, Liabilities, Owners' Equity, Revenue, Expenses, Profit and Loss.

Ch.9. *Financial reporting* (Art.57-64): generally illustrating financial statements, including: balance sheet, income statement, statement of changes in financial position, cash flow statement.

Ch.10. *Supplementary provisions* (Art.65-66): no substantial content. Only stipulating that the MOF will be in charge of the explanation of the standards, and the effective date of the ASBE is on July 1st 1993.

By viewing the general description of the ASBE, one can see that these basic accounting standards looked very similar to an accounting conceptual framework of the western accounting standard setting. As described by FASB in its Statements of Financial Accounting Concepts (SFAC) (1993, p. 177), "the conceptual framework is a coherent system of interrelated objectives and fundamentals that is expected to lead to consistent standards and that prescribes the nature, function, and limits of financial accounting and reporting". But "establishment of objectives and identification of fundamental concepts will not directly solve financial accounting and reporting problems. Rather, objectives give direction, and concepts are tools for solving problems".

Regarding the question, if the already promulgated Accounting Standards for Business Enterprises (ASBE) is able to serve as the basis for developing a series of specific accounting standards, some Chinese researchers also think (Yan, Xu, 1995, p. 149-150. In Chinese), that it's only possible for it to have such characteristics as advanced theories, complete contents and

foresighting methodology. They think that one of the obvious shortcomings with ASBE is to give little consideration about reality of the economic operations in China. As the result of the fact that many factors, such as different ownership, different ways of operation, are not fully touched, discordance between the accounting reform and reforms in other professions might emerge, and many loopholes may appear in the real accounting operation.

2.1.3.2 The revised accounting standards

The revised Chinese accounting standards (RAS), a new version of the ASBE, promulgated by the MOF was effective on January 1, 1998. It introduced important changes to existing practices. These include relaxation of previously rigid limits on provisions for bad debts, on inventory and temporary investment valuation. IAS is issued under separate headings for individual accounting subjects (fixed assets, inventories and foreign currency transactions). Each standard of RAS provides definitions for the key terms relevant to the subject matter, discusses the main issues and their prescribed accounting treatments, as well as their disclosure requirements.

The RAS functions more as a detailed accounting manual for accountants working in the field. It begins with a standard chart of accounts, followed by detailed descriptions of the contents of all the accounts and the relevant double entry for routine transactions. There is also a format for a set of standardized financial statements, together with detailed instructions on how to complete the standard format. To sum up, the RAS has more breadth but less depth than the IAS. (Leung, 1999). In addition to the RAS, in 1993, the Chinese MOF started a long-term programme to develop a set of specific accounting standards. These standards will be similar in nature, format and contents to the IAS. These standards include the more common topics, for example, inventory and foreign currency transactions, and the not-so-common topics such as liquidation accounting and debt-restructuring. Particular attention is given to topics, which meet the

immediate needs of economic reform. Since the RAS is a new version of the ASBE, when the ASBE mentioned in the following sections, it refers to the RAS.

Principally, the revised accounting system promulgated by Ministry of Finance of China in 1998 is applicable to all H-share and B-share and A-share issuers. However, some of the requirements are mandatory for H-share and B-share issuers, but are optional for A-share issuers. For example, the revised Accounting System sets out requirements for various types of provisions, such as doubtful debt provisions, provisions for realizable values of inventory and short-term investments. A-share companies are not required to prepare International /Hong Kong financial statements, and traditionally, make virtually no provisions. If A-share companies were required (rather than allowed) to make provisions, their profits would go down, and many "profitable" companies would turn into loss making entities. That would it hurt their stock prices. (Leung, 1999).

2.1.3.3 Specific accounting standards

The ASBE can be seen a sign of preliminarily success of the Chinese accounting reform, which aimed to replace the old, uniformed accounting regulation with accounting standards. After promulgating these basic accounting standards, the MOF immediately stipulated accounting regulations for 13 industries, including, manufacturing, merchandising, traffic and transportation, traffic and transportation enterprises (railway), traffic and transportation enterprises (airline), post and telecommunication, tourism and catering, construction, real estate development, agriculture, foreign trade and cooperation, banking and financing, insurance. But an accounting reform can not be accomplished over a night. As a researcher (Liu, 1996, p.273) comments, "even though, the MOF has emphasized that these regulations were based on ASBE, from its natures and requirements, it was not radically different from the old uniformed accounting regulations, it was just some changes on certain accounting treatments.

Thus, the promulgation of the basic ASBE was just a liberation from thoughts, but the accounting practices was still kept unchanged”.

As mentioned, the ASBE promulgated by the MOF is only a basic standard, which acts as a conceptual framework and as guidance in the whole accounting standards system of China. In order to truly implement the ASBE, based on the study and summarization of the implementation effects and experiences of the ASBE, since the later part of 1993 the MOF has hurried its step in the specific accounting standard promulgation. From February 14th 1994 to January 1996, the accounting department of the MOF has formally promulgated 30 inquiring exposure drafts (IED) in 6 batches. According to Liu, (1996, p. 273-274), they are as follows:

MOF promulgated a set of specific accounting standards, which

Batch 1. (Feb. 1994), IED1: payables (including: debt restructuring).

Batch 2. (July 1994), IED2-7: receivables (including: debt restructuring), inventory, investments, capitalization of borrowing costs, balance sheet, income statement.

Batch 3. (Apr. 1995), IED8-14: fixed assets, intangible assets, owner’s equities, long-term construction contract, research and development, cash flow statement, basic business of banks.

Batch 4. (July 1995), IED15-21: deferred assets, revenue, foreign currency exchanges, income tax, consolidated accounting statement, accounting policy and changes in accounting policies and accounting estimates, events occurring after the balance sheet date.

Batch 5. (Sep. 1995), IED22-26: employee benefits, donations and government assistance, contingent events and commitments, disclosure of related party relationships and transactions, liquidation.

Batch 6. (Jan. 4, 1996), IED27-30: leases, future, enterprise combination, non-currency transactions.

From May 22nd 1997 to June 26 1998, eight specific accounting standards were formally promulgated. All of them have already been listed in the above mentioned inquiring exposure drafts, they are: Disclosure of Related Party Relationships and Transactions, Cash Flow Statements, Events Occurring after the Balance Sheet Date, Debt Restructuring, Investments, Construction Contracts, Changes in Accounting Policies and Accounting Estimates, Revenue. According to the MOF (1999), among these eight specific accounting standards, only Cash Flow Statements and Debt Restructuring are applicable to all enterprises while the remaining six are initially applicable to listed companies.

In terms of international practice, accounting standards do not deal with the setting up, application and accounting treatment for each account, but instead they mainly regulate accounting policies of recognition, measurement, and reporting for enterprises. They provide the requirements for recognition, measurement and reporting of accounting elements, special accounting treatments for special transactions, and the disclosures in financial statements (Lu, 1995, p. 35. in Chinese). When prescribing the specific accounting standards, Chinese MOF has, to a large extent, taken the IAS as reference. The standards have the same structure as the IAS, which consists of four sections: introduction, definitions, standard, and appendix.

2.1.3.4 Standards issued under the stock market force

As Kam (1990, p. 47, 554) said, “throughout history, accounting has been responsive to the needs of its users”. The Chinese accounting standard-setting is also effected by and being adapted to the stock market’s developing requirements and users’ demands.

The size of China's capital market is rather small, and immature, it affects China's accounting standards setting and promulgating one way or the other. Besides the issued specific accounting standards, the MOF will prescribe and promulgate some other specific standards in relation to those accounting matters which have just occurred and need to be solved quickly in the security market (Qu, Chen, 1998, p.8). Compared with the Western countries, China's capital market started late, and still is under development. Many economy events which are popularly seen in the West have just occurred or not yet appeared in China's capital market, such as, preference share, convertible bond, etc. (Zhu, 1998). Therefore, when prescribing and promulgating accounting standards, one has to consider the above factors, and distinguish them from the Western accounting standards.

“A standard-setting board should not be overly concerned with long-range abstract goals, but should be responsive to immediate and real problems calling for attention now” (Kam, 1990, p.554-555). This point of view has also been demonstrated by the development of China's standard-setting process. As Feng, the director of the Accounting Department of the MOF, says, “the way of thinking need to be changed, accounting standards should be promulgated according to the demands. That is, what is issued is what is demanded” (Yuan, Wen, 1998, p.13).

Thus, the influences of the security market on China's accounting standard-setting can also be reflected in the 8 specific accounting standards issued. As noted, six of eight specific standards issued are initially applied to listing companies. Also, with reference to the earlier mentioned investigation concerning Chinese listed companies (Qu, Chen, 1998, p.8), eight of the 30 inquiring accounting exposure drafts are urgently demanded on the capital market. Those demanded events mostly comprise what is important for a listing company to disclose in the way of useful and reliable information in its annual report. They are: consolidated statements, disclosure of related party relationships and transactions, enterprise combination, investments, cash flow statements, income tax, the

intangibles, changes in accounting policies and accounting estimates. We have noted that four of them have been formally promulgated as specific accounting standards. Thus, one can conclude that stock market demands have great influences on China's accounting standards setting.

2.1.4 Information disclosure

Requirements for information disclosure in China

It is well recognized that the demand for both financial reporting and auditing is significantly influenced by, among other factors, the extent of the separation between owners and corporate management (Xiang, 1998). The old time accounting information in China was only used to serve the needs of the government and managers of enterprises. Since these two users, actually, are the same in nature in the context of the contemporary China, it was by no means necessary to disclose this information. However, the requirements of the stock market for providing accounting information are not only to the government and management, but also to external users. The accounting information disclosure to the public investors was called for.

China has really disclosed financial information since the set-up of the Shanghai Stock Exchange (SHSE) (1990) and the Shenzhen Stock Exchange (SZSE) (1990). The earliest information disclosures were made by eight companies, at that time listed on the SHSE. The information included mainly the financial status of the companies (in equivalence to a simplified balance sheet and the statement of profit and loss), forecasts for the profitability, distributions of dividends. Also, some vital information that influenced or would influence assets, liabilities, and shareholders' equity of a company had occurred in the past or would occur in the future. The disclosures of these eight companies only took one and a half pages of a newspaper (Zhang and Li, 1998, p.52).

The requirements for information disclosure in China are, to a large extent, after the model of the regulations for the Securities Exchange Committee

(SEC) in the U.S. The purpose of the requirements of accounting information disclosure is to provide investors with sufficient, reliable and comparable information such as business operations and financial positions about a targeted listing company on time, so as to facilitate investors to better understand a risk and return in a future investment. On the other hand, each company is commanded to file periodic reports with the securities market regulatory and supervisory body – the China Securities Regulatory Commission (CSRC). Their reports are the major sources for the CSRC to censor and monitor, hence, they are used to determine the entitlement for a listing of the company in the securities market. As a result, it is an obligation for these companies to submit and present accounting information contained in their reports with a manner of accuracy, integrity, and authenticity.

In China, listed (A-, B- and foreign listed shares including H-, N-, and S-shares) companies are requested to disclose accounting information and must follow both the Accounting Standard for Business Enterprises No. 1-Basic Standard and the Accounting System for Companies Limited by Shares. The former Accounting Standard for Business Enterprises is described as an accounting standard, but it is more like a conceptual framework or statement of principles. It was released by the Ministry of Finance (MOF). The latter was tailor-made for share-issuing companies, which was jointly issued by the MOF and the State Commission for Economic Reforms in 1992. It is laid out in line with the Accounting Standard for Business Enterprises, but the standards are only restricted to be applicable for listed companies. This regulation has been revised recently, and became effective as from January 1, 1998. These two sets of regulations together govern the requirements for preparing financial statements for listed companies and mainly deal with accounting assumptions, accounting principles, accounting elements, recognition, measurement and financial statement issues, etc.

Listed companies are also subject to the Bylaws of Information Disclosure for Publicly Traded Companies (1993) and the Content and Format of Annual Reports (1994) released by the CSRC. In the following years, the CSRC subsequently issued the Footnotes Indices for Financial Statements and the Content and Format No. 7 of Prospectus. Besides, the CSRC revised the Content and Format No. 1- Registration Statement, No. 2 - Annual Report, and No. 3 - Interim Report in 1997. Along with the Accounting Standard for Business Enterprises and the Accounting System for Companies Limited by Shares, the Content and Format and the Footnotes Indices for financial Statements dictate the content and forms for Registration Statements, Prospectuses, Annual Reports, and Interim Reports.

Apart from preparing financial statements with respect to the Accounting Standard for Business Enterprises and the Accounting System for Companies Limited by Shares, B-shares issuing companies have to provide summarized financial statements in terms of IAS or Hong Kong GAAP. Furthermore, the Chinese accounting standards based financial statements must be audited by independent accountants, who normally are from Chinese accounting firms that are qualified by the CSRC. The IAS based financial statements for B-share companies, on the other hand, should be audited by the Big 5 (Arthur Andersen, KPMG Peat Marwick, Ernst & Young, Deloitte & Touche, and Price Waterhouse & Coopers) auditors and other international firms.

Companies issuing H-shares must conform to the disclosure requirements for listing on the Hong Kong Stock Exchange, which has stricter information disclosure requirements than those of A- or B-shares. Requirements for N-shares and S-shares are pursuant to listing local exchanges.

In general, the CSRC requires that periodic reports and current reports be prepared constantly so as to ensure the information that might fluctuate the

securities' prices to be given out to investors. The Content and Format No. 2 and No. 3 prescribe the requirements for annual reports and interim reports for accounting information disclosure, respectively.

It was framed fully based on the requirements for disclosure by the SEC, that the content and format of accounting information disclosure in China is supposed to be thorough as a whole. (Zhang and Li, 1998, in Chinese). We would like to exhibit the requirements for the annual report disclosure by the Content and Format released by the CSRC in the attached Appendix 1, in order to facilitate readers to have an overall picture in Chinese annual report disclosure requirements. The thought for using the requirements for annual reports is that we think the content of the annual report is typical and representative in disclosure requirements in comparison with the interim report. Most items required to be disclosed by the interim report are included in annual report. Also, the current report is included in annual report. Therefore, we chose to discuss only the annual report instead of all of them.

2.2 Stock-market oriented accounting

As noted, China established its new accounting system only few years ago. This is a system completely different from China's old uniformed one, where no more experiences can be taken as references for its current standard-setting. Therefore, as the MOF stated, the current standard-setting is based on experiences of other countries and the IASC. Some questions will then be raised, since what we are interested in here is what experiences the MOF has taken as reference, what has been abandoned or ignored, are there some places for a further improvement in the MOF standard-setting? To know what current accounting standard setting in China is really about, we feel that to shed light on China from only one hand is not enough, one also needs to get a step further to study good samples of standard setting in other countries, and compare them with China.

In the following section, we would like to generally describe accounting standard-setting in the U.S. The reason for us to take the U.S. FASB rather than the IASC is: first, we think that IASC is an organization with broad representatives from accountancy bodies of many countries. It is not proper to take an individual country, such as the MOF of China, as a comparison party to the IASC. That is, as stated, we need to select a country sample to be compared with China; second, the IASC is widely seen as an accounting based on Anglo-Saxon principles. Also, as noted, the U.S. Deloitte Touche Tohmatsu International plays an important role in China's accounting standard setting process, and thus retains a significant measure of influence. Therefore, it is natural and rational for us to choose the U.S. standard setting body, the FASB, as a counterpart to China's MOF.

2.2.1 Regulation

2.2.1.1 Standard-setting body in the U.S.

With reference to disclosure of the FASB (www.fasb.org), financial accounting and reporting standards are established by the FASB, with advice from the Financial Accounting Standards Advisory Council (the Council). These two organizations are funded by the Financial Accounting Foundation. Its Board of Trustees is made up of nominees from sponsoring organizations and from other fields. The sponsoring organizations are:

- American Accounting Association
- American Institute of Certified Public Accountants
- Association for Investment Management and Research
- Financial Executives Institute
- Government Finance Officers Association
- Institute of Management Accountants
- National Association of State Auditors, Comptrollers and Treasurers
- Securities Industry Association

Besides the nominees from sponsoring organizations, there are also large amount of trustees not nominated by those organizations, for example, about 7,000 public accounting firms and individual CPAs are members

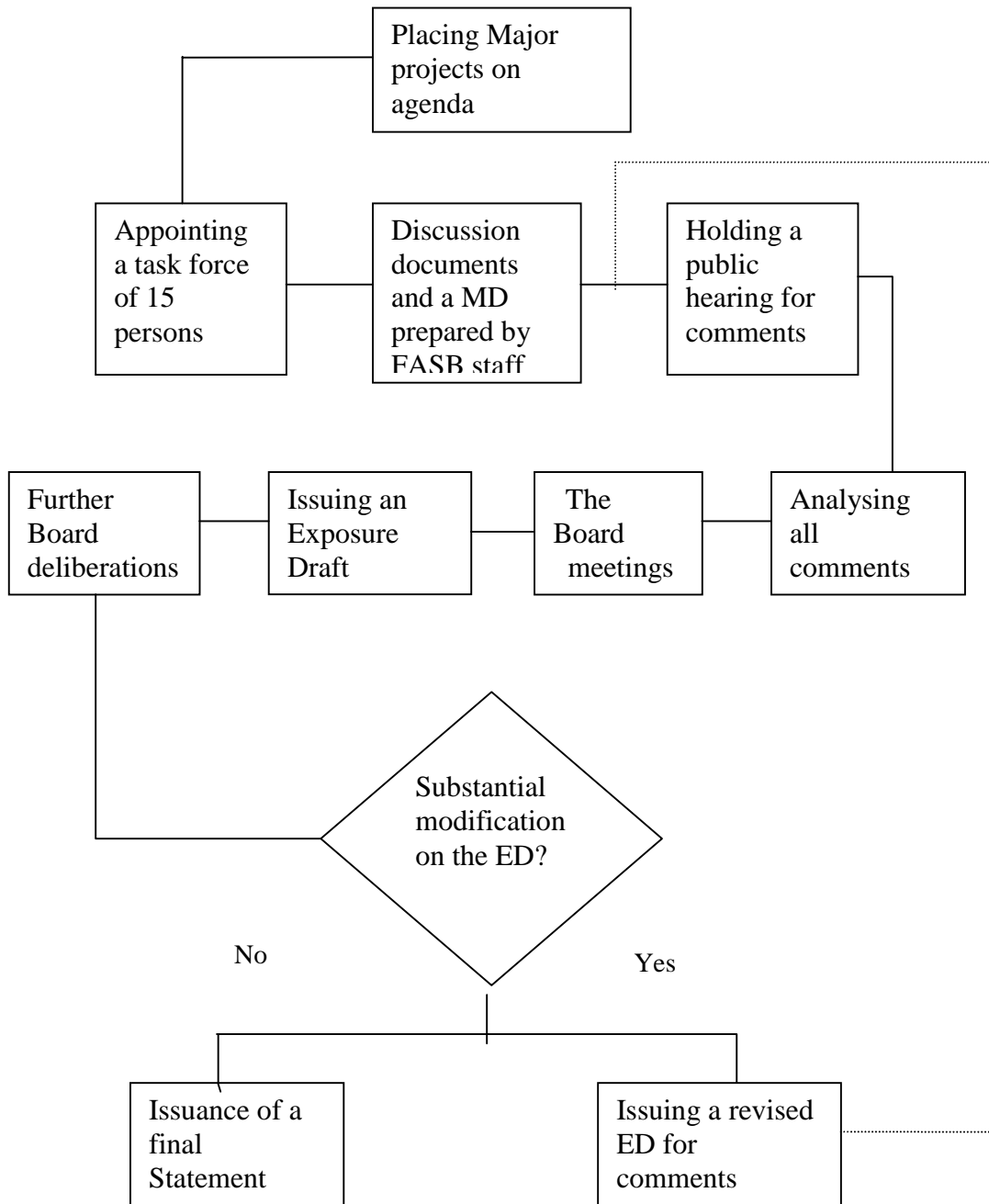
through the Accounting Research Association of the American Institute of CPAs.

The Council is responsible for advising the FASB on issues related to projects on the FASB's agenda, possible new agenda items, project priorities, procedural matters, and other matters as requested by the chairman of the FASB. It has broad representatives of preparers, auditors, and users of financial information. The members of the Council are drawn from the ranks of chief executive officials (CEOs), chief executive financial officials (CFOs), senior partners of public accounting firms, executive directors of professional organizations, and senior members of the academic and analyst communities. As the FASB asserts, "the Council provides an important sounding board to help the FASB understand what constituents are thinking about a wide range of issues. It operates as a window through which the FASB can obtain and discuss the representative views of the diverse groups the FASB affects, and provides the forum for two-way communication" (www.fasb.org).

2.2.1.2 Accounting standard-setting procedure in the U.S.

The FASB is required by its Rule of Procedure to follow an extensive "due process" that is open to public observation and participation. This due process can be portrayed as in the following flow chart:

Figure 2.2.1.2 Due process of FASB's standard-setting



Notes:

DM: Discussion Memorandum

ED. Exposure Draft

Source: based on information provided in the FASB's Website: (www.fasb.org).

The U.S. standard-setting procedure can be seen in the above figure of due process of the FASB's standard-setting, which is departing from setting major projects by the task force, to formulating an accounting standard at the end. In the process, based on a Discussion Memorandum or another discussion document prepared by the FASB staff, a later public hearing will be held; from which comments will be received as a basis for meetings of the Board for the issuance of an exposure draft; after that, a further deliberation will then be taken, and a second public hearing might be considered by the Board if necessary for forming a revised exposure draft; finally, a final statement will be set.

2.2.1.3 American approaches to standard setting in the U.S. – the issue of power

According to Kam (1990, p. 552), 1,329 responses to a survey regarding the question of “whether standard setting should be in the private or public sector”, reveals that the overwhelming majority, 91.9 percent, favored the placement of the standard-setting function in the private sector. The reasons are presented as follows: 1) The people on the board would have more expertise. One reason is that a governmental board would not be able to offer salaries high enough to attract those in private practice who have the experience and technical knowledge. Based on the selection process of other similar boards in government, political factors appear to play a more important role than knowledge and experience; 2) A board in the public sector would be more subject to pressures to help accomplish the socioeconomic objectives of the government; 3) A board in the private sector commands more prestige and acceptability by the business community.

2.2.2 Valuation rules

In the following part, we will give a brief view of the IASC and the standards (IAS) it issued. It may confuse readers a little. As we have taken the U.S. FASB as a counterpart to the Chinese MOF for regulation section, why do we not directly take the standards of the FASB to compare with

Chinese accounting standards? In general, it is because that we think Chinese accounting standards issued are much more close to the IAS compared with any other set of accounting standards.

As mentioned earlier, the Chinese MOF promulgated the accounting standards including the ASBE and the specific accounting standards, as well as those inquiring exposure draft of accounting standards are mainly based on the IAS. However, this is not a wholesale adoption for China. Strictly speaking, it is a set of accounting standards with Chinese features, which integrate the IAS with the characteristics of China. This means that the IAS is taken as reference with some adjustments to fit China's special situation. In order to give a comprehensive and appropriate assessment of China's new accounting system, we compared accounting standards in the following section.

2.2.2.1 About IASC

History

The International Accounting Standard Committee was founded in 1973. At that time, it had only nine committee members. They were, Australia, Canada, France, Japan, Mexico, the Netherlands, the UK, Ireland, the United States and West Germany (Jones, 1998). However, since then it has expanded rapidly and become a very influential accounting standard committee, with 134 Member Organizations, 5 Associate Members, and 4 Affiliate Members in 104 countries. The members of IASC consist of all professional accountancy bodies that are members of the International Federation of Accountants (IFAC), and it is professional accountancy bodies rather than governments that representatives of IASC memberships come from. China joined the IASC in July 1997. The Chinese Institute of Certified Public Accountant (CICPA) is also a member of the public sector Committee of the International Federation of Accountants (IFAC) (www.iasc.org.uk). It is believed that China's membership in the IASC and IFAC should help the Chinese profession's involvement in international affairs, and make a contribution to the international accounting

harmonization, as well as allow exchange with the international community (Tighe, 1997).

Impact of the IASC

The fundamental aim of the IASC has been to increase the compatibility of accounting standards worldwide. As it states: “to formulate and publish in the public interest accounting standards to be observed in the presentation of financial statements and to promote their worldwide acceptance and observance”. A key feature of the IASC is its voluntary nature, meaning that standards are persuasive rather than mandatory. Thus, IAS are usually incorporated into the national regulation through internal national mechanisms (Jones, 1998).

The IASC has its impacts worldwide. According to Jones (1998), it has possible impacts on less developed countries, European countries and capital market countries. The influence of the IAS is strongest in the less developed countries. Many, such as Malaysia, Nigeria and Singapore, have adopted IAS as a cheaper alternative than developing their own standards. The newly issued Chinese accounting standards are also based on IAS. In China’s stock exchange, companies that have issued B-Shares (traded in China and overseas) must follow IAS; companies that have issued H-Shares (traded only in Hong Kong) may follow either IAS or Hong Kong accounting standards; companies that have issued A-Shares (traded in China only) must follow the domestic accounting standards (www.iasc.org.uk). According to the information identified by the IASC Secretariat in published annual reports, there are 104 Chinese enterprises that have chosen to use IAS when preparing and disclosing their financial statements.

IAS is also preferable in continental Europe. Even so, there is ambivalence to IAS in some countries, such as, France and Germany, where a very regulated, tax-driven and creditor-based accounting practice has traditionally been favoured. In some European countries, such as France

and Switzerland, companies must use national requirements for the financial statements of individual enterprises, but are free to use IAS in the group financial statements. Other European countries, such as Belgium, Denmark, Germany and Italy, are all in the process of passing laws that will allow some or all listed companies to use IAS instead of domestic standards.

Capital market countries, such as the US, Canada and the UK, generally have standards, which already approximate to IAS. But, here has been a great reluctance to endorse fully all aspects of the IAS there (Jones, 1998).

2.2.2.2 IAS in brief

It is believed that the impetus of the IAS will be gained more and more in the future. Especially since it drew an important agreement with the International Organization of Securities Commission (IOSCO) in July 1995. In that agreement, the IASC promised to complete a core set of standards by 1999. According to the IASC (www.iasc.org.uk), IOSCO's list identified 40 core standards, which consist of 3 general standards, 13 standards concerning income statement, 13 standards concerning balance sheet, 1 standard of cash flow statements, 10 other standards. Once this core set of standards is in place, IOSCO has pledged to consider them for endorsement. As they announced publicly in July 1995, "completion of comprehensive core standards that are acceptable to the IOSCO Technical Committee will allow the Technical Committee to recommend endorsement of IAS for cross border capital raising and listing purposes in all global markets". As Jones (1998) comments, "If the deal goes through, IAS will become the norm for international listings as an alternative to national accounting standards. Otherwise, it is likely that the IASC will lose some of its impetus".

Since we will compare the IAS with Chinese accounting standards in a later section, here below we think it necessary for us to give a brief introduction of the current IAS. With reference to the IASC

(www.iasc.org.uk), so far, it has issued 39 standards, with 5 withdrawn including IAS3, IAS5, IAS6, IAS9 and IAS13. The other 34 standards are still effective. They are as follows:

IAS1-2: Presentation of financial statements, Inventories;

IAS4: Depreciation accounting;

IAS7-8: Cash flow statements, Net profit or loss for the period & Fundamental Errors and changes in accounting policies;

IAS10-12: Events after the balance sheet date, Construction contracts, Income taxed;

IAS14-20: Segment reporting, Information reflecting the effects of changing prices, Property, plant and equipment, Leases, Revenue, Employee benefits, Accounting for government grants and disclosure of government assistance;

IAS21-30: The effects of changes in foreign exchange rates, Business combinations, Borrowing costs, Related party disclosures, Accounting for investments, Accounting and reporting by retirement benefit plans, Consolidated financial statements and accounting for investments in subsidiaries, Accounting for investments in associates, Financial reporting in hyperinflationary economies, Disclosures in the financial statements of banks and similar financial institutions;

IAS31-39: Financial reporting of interests in joint ventures, Financial instruments – Disclosure and Presentation, Earnings per share, Interim financial reporting Discontinuing operations, Impairment of assets, Provisions, Contingent liabilities and contingent assets, Intangible assets, Financial instruments – recognition, and measurement.

2.2.3 Information disclosure

In this section, we will briefly introduce information disclosure in the U.S. The reason for our choice is, as mentioned earlier, that the study is based on the logic that the IAS approximately equals the SFAS of the U.S. There is no any securities market appointed to the IAS as the only authorized accounting principles in making financial statements, up to now. We then suppose that the U.S. stock market could be taken as a proper model for comparison with China, which is applying an IAS-based accounting.

Requirements for information disclosure in the U.S.

In the U.S., the Securities Exchange Act of 1934 is the principal statute regulating periodic reports. (In addition to 1934 Act, 1933 Act is another very important act in securities markets. We will discuss two securities acts and the Securities Exchange Commission in further sections in our paper.) Before we enter into the requirements for information disclosure in the U.S., it is necessary to explain the relationship between the Securities Exchange Commission (SEC) and the Financial Accounting Standards Board (FASB). The accounting standards that are applicable to the financial statements are either from the generally accepted accounting principles (GAAP) or the SEC itself in the States. The SEC is empowered by the Securities Act of 1933 to prescribe accounting standards by its own and the SEC has assigned the FASB, a private sector, to formulate accounting standards for it. These standards, named as Statements of Financial Accounting Standards (SFASs), have been recognized as authoritative by the SEC and the American Institute of Certified Public Accountants (AICPA). The SEC acts “in only a supervisory capacity unless it deems it necessary to intervene” in accounting standard setting (Radebaugh and Gray, p.88). However, the SEC has an absolute priority in making a final judgement if there is a dispute with the FASB.

There are plenty of forms and statements required to be filed with the SEC. One of the most important documents is Regulation S-X, which is the

authoritative statement of standards for financial statement disclosure under the Securities Act of 1933 and the Securities Exchange Act of 1934. The Regulation S-X has the effect of law (Buckley, Buckley and Plank, 1980, p.51). In Regulation S-X, it lays down the content and form of the financial statements required in the registration and periodic financial reports filed with the SEC. The companies who issue securities for the first time need to fill out Form S-1 (registration statement). An annual report and quarter report should abide by Form 10-K and Form 10-Q, respectively. For the occurrence of significant events, Form 8-K is used.

It is worth mentioning the Regulation S-K, which defines information to be reported by industry segments that conform to Statement of Financial Accounting Standards (SFAS) “Financial Reporting for Segments of A Business Enterprise” of the FASB. Along with the Regulation S-X of the SEC, they prescribe the requirements for the content and form in the financial statements. In spite of the GAAP, the FASB enacts detailed accounting standards in preparing financial statements. Except for full disclosure regulated by the SEC, the FASB requires the financial reports be materiality and general-purpose sources of financial information designed to serve the common needs of all users. Meanwhile, the financial information residing in such as income statements, the statement of financial position (including statement of retained earnings and statement of stockholders’ equity), the statement of changes in financial position, notes to financial statements, audit reports, and supplemental information must be provided relevant and reliable. We also attach the main captions comprising the annual report required by the SEC within Appendix 2.

2.3 Comparison of accounting systems

In the proceeding sections, we have described different types of the accounting systems, including accounting system of China, the IASC, and the U.S. As noted, the descriptions of accounting systems are made from three aspects, regulation including the regulators (standards-setting bodies), regulation process (standards-setting procedures), and valuation rules (the

specific standards), as well as a information disclosure consisting of disclosure requirements of stock markets. As noted, the Chinese accounting system has to a large extent replicated the experiences of other countries, especially the IASC and the U.S. In order to give a complete view and an appropriate assessment to the Chinese current accounting system, in the following sections we will compare the accounting system of China, the IASC and the U.S. The comparison of these different types of accounting systems will be conducted on these three dimensions: regulation, valuation rules, and information disclosure. The U.S. will be taken as a counterpart to China for regulation comparison; while, the IASC will be for the valuation rules comparison. The reason for our choosing these models have been stated when we described the different accounting system individually in the earlier sections.

2.3.1 Regulation comparison between China and the U.S.

2.3.1.1 Standard setting body – public VS. private sector

As noted, the standard setting body in China is a public sector organization. Therefore, the independence of standard setting is very weak. The accounting standards are prescribed by the central government. The Department of Administration of Accounting Affairs (DAAA) within the MOF has been the sole authoritative standard setting body. It was until Oct. 12th, 1998 that the MOF founded Chinese Accounting Standard Committee (CASC) to engage in setting accounting standards. However, the nature of its public sector has never been changed. The MOF has full responsibility for administering accounting activities. The power of professional accounting bodies in China is very weak in accounting standard setting. The professional accounting bodies of the Accounting Society of China (ASC) and the China Institute of Certified Public Accountants (CICPA) are both branches of the MOF. Even though they may also express opinions from time to time on some specific accounting issues. Their opinions, however, are not as influential as pronouncements promulgated by their American counterpart, the FASB.

In contrast, in the U.S., accounting standards are traditionally promulgated by professional organizations. The standard setting body, FASB, is seen as a private-sector organization. Even though, it is officially recognized as authoritative by the SEC, which is a functional department of government and has statutory authority to establish financial accounting and reporting standards for publicly held companies. The FASB is independent of all other business and professional organizations, and with a high degree of authority in charge of the formulation of accounting standards. The independence of the accounting standard setting is thus emphasized. It is regarded in the States that a standard setting body remaining in the private-sector can better represent the interests of those private-sector participants.

2.3.1.2 Standard setting procedure

When comparing China's accounting standard-setting process with the due process of the FASB, one could find that, from a general perspective, they do not have any essential divergences on overall procedures designed. The China's MOF stated that the Chinese accounting standard setting was established by taking other countries' experiences, including the U.S. but, when carefully reviewing them both in detail, some distinctions have still been called into our minds.

When going through the U.S. standard-setting process, we have found that this is characterized by "the very diverse group" represented in the standard-setting body and "an open" standard-setting process. We think that these have been lacking, and are weaknesses in the Chinese standard-setting, and may require more attention of the MOF for a further improvement, in order to create a more appropriate environment for an IAS-based accounting standard-setting and implementation in China. These two distinctions will be further expounded as follows.

Rather limited representatives in China's standard-setting

As noted, there are broad representatives from very diverse group in the U.S. In order to ensure that various points of view on the issues involved

are represented, a task force consisting of preparers, auditors, and users of financial information, and experts from other disciplines, is appointed in advance. It is especially for advising and assisting the FASB staff to conduct major projects. “Task forces play an important role in the standard-setting process by providing expertise, a diversity of viewpoints, and a mechanism for communication with those who may be affected by proposed standards” (www.fasb.org).

In China, there seems to be no such an advice group to cooperate with in advance. How a topic is added in the MOF’s agenda and how the communication between the MOF draft staff and those affected parties is set, has not been clearly disclosed. Even though, as noted, a foreign hired consulting group, DTTI, is mainly responsible for a comparative study of the world’s accounting standard-setting, and provides some theoretical advice, one can not expect much on a foreign consulting group that is not familiar with in dealing with China’s practical problems. 10 domestic professionals of the expert consulting group are mainly from the academic field, which means that they might not be that sensitive to the benefits of an enterprise. Therefore, persons engaging in real business practices are not included from the very start of China’s standard-setting process. Then, the question whether a diversity of viewpoints of people from varied business and professionals can really be taken into the consideration in advance of a proposed standard-setting, does require one’s concerns. In China, the MOF has absolute power in the standard-setting process and making decision. The voices from other relative interest parties of the society seem to be seldom heard from beginning of this process.

The procedure of public hearing in FASB due process can not be seen in China’s standard setting. In the U.S. procedure, a Discussion Memorandum or other discussion documents have been prepared by the FASB staff in advance for both written comment and oral presentations at a public hearing. It is held to provide an opportunity for a two-way communication between the draft persons (the Board and staff) and interested parties. The

public hearing procedure is held before a proposed exposure draft. While, in China, there is no public hearing held before the issuance of an exposure draft of an accounting standard. It seems mainly be an literature-based process, and a little concealed. In the stage of researching, the draft persons make a preliminary conclusion based on broadly collected materials and a comparative study report of DTTI; in the later drafting stage, the draft persons form a preliminary draft of an accounting standard also based on the studies and researches; it will be revised after discussion within a core group or accounting standard groups whose members are from the MOF.

However, there is a procedure, which is similar to the public hearing in nature. It is a soliciting opinion stage of China's accounting standard-setting process. But, quite notably, it is the last step in China's standard-setting that the opinions concerning the draft accounting standard are solicited. Here, some more parties are involved, such as, experts consulting groups, Bureaus of Finance of each area, and concerned authorities of the State Council. We think that even though the comments are asked for here after an exposure draft is prepared, a substantial modification concerning the exposure draft is unlikely to happen. Thus, it would be better if this procedure can be held at an earlier stage before formulating a draft.

An more concealed standard-setting in China

Unlike the standard-setting processes in most western countries, the formulation of the uniform accounting system and regulations has been the domain of the Ministry of Finance, the industrial ministries and some provincial government agencies. Neither a special committee under the People's Congress, nor a professional organization has ever actively participated in the decision-making process (Zhang, 1996). It is anticipated that the Ministry of Finance will continue to play an important role in the standard-setting process.

The decision-making process in the U.S. seems more open than in China. It is under the Rule of Procedure that FASB and the council are required to

follow an open, orderly process that is open to public observation and participation. According to the FASB (www.fasb.org), “Significant steps in the standard setting process are announced publicly”. As mentioned, a Discussion Memorandum or other documents for comments at a public hearing are published and broadly distributed. Task force meetings and board meetings are open to public observation, and a public record is maintained. In the public hearing, “any individual or organization may request to be heard...public observers are welcome”. A public record including the hearing transcript and written comments will also be published and available at any time. Additionally, in order to keep the public informed of developments on its projects, the FASB also releases a newsletter, a Status Report, and Action Alert which is a weekly notice of upcoming Board meetings and their agendas with brief summaries of actions taken at previous meetings.

The accounting standard-setting process seems more concealed in China. One can hardly find the information concerning the specific procedure. As a researcher (Liu, 1996, p. 291) complained, “the drafting process of stage 3 seems not open, since nothing concerning the research reports has been found, and nothing has been published by accounting department of the MOF to illustrate that research reports concerning certain accounting standard have been finished, and are available openly to the public”.

2.3.1.3 Our points of view regarding the openness in the standard-setting process

Concerning the point of openness in process, in our opinion, it might be determined by the nature and structure of a standard-setting body to a certain level. For example, in some way the FASB can be called a private-sector organization empowered to establish financial accounting and reporting standards. The FASB turns to many other organizations and groups for advice and information on various matters, including its agenda. Among the groups, with which liaison is maintained, are the Financial Accounting Standards Advisory Council, the Accounting Standards

Executive Committee and Auditing Standards Board of the AICPA, and the appropriate committees of such organizations as those earlier mentioned, eight sponsoring organizations of the FAF. Also, the SEC will send their requests for action to the FASB. These large constituents involved have broad representatives of preparers, auditors, and users of financial information. All of these factors determine that the process of FASB standard setting must not be of any other kind but only be “an open decision-making process”, to ensure that various points of view of all these interested parties on the issues involved are represented. As Kam (1990, p. 561) says, “the profession seems to have little choice but to yield to the demands of corporate management, congressional committees, and presumably the public for a more democratic process in establishing accounting standards. Because the formulation of standards often involves an interpretation of different theoretical points and types of evidence, knowledge of the views held by various interested parties is helpful to the FASB”.

Also, the situation in the U.S. is, in contrast with China, where the FASB is seen as a private standard setting body; the State acts as taxation authority; and the companies are private-owned, and they influence the U.S. standard setting to a large extent through their representing in the FASB. Under most circumstances, the benefits of companies (taxpayers) stand opposite to the national benefits (tax levier). Therefore, it is significant for the U.S. companies to exert their influences in the standard-setting process, in order to safeguard their own interests and get standards biased to their benefits.

In China, the accounting standard-setting body is the Accounting Department of Ministry of Finance, which is a typical governmental authority directly under the jurisdiction of the State Council. The MOF is mainly in charge of levying fiscal (tax) revenue for the nation, and is a charging authority of most state-owned enterprises; the Accounting Department is also a functional unit within the MOF. Main activities regarding accounting standard-setting need be reported to and approved by

the Ministry leaders. Thus, it can be seen that the MOF represents both government (standard-setting body, and standard users through taxation) and the state-owned enterprises (standard preparers and users), which are still dominating in China's economy (Liu, 1996, p.297).

Undoubtedly, the benefits of the state are first represented in China's standard setting. The state-ownership can be reflected in a broad economy area of China. Virtually, the state still wholly owns or majority owns almost all the large industrial and commercial business (Xiang, 1998). This is evidenced by the sustained state dominance among China's 1,000 largest industrial enterprises in recent years; A-share and B-share issuing firms listed on domestic stock exchanges are majority-controlled directly by the state or indirectly by other state-owned and state institutions (this can be seen in our later section on China's stock market); significant state ownership is also prevalent among China's H-share and N-share issuing companies that are listed in overseas stock markets, such as the Stock Exchange of Hong Kong and the New York Stock Exchange. Furthermore, the four largest banks, such as Bank of Industry and Commerce, Bank of China, Bank of Agriculture, and Bank of Construction, are also owned by the State, and these national banks are main financial system of China, they still play a key role in funding the state-owned enterprises and as main creditors to the state-owned enterprises through national loan and appropriation.

Thus, one may attribute the special feature of China's accounting standard-setting to the multi-functional role represented by the MOF. It needs to represent benefits of the nation. Since it acts as a *public standard-setting body*, *taxation authority (accounting information users)*, and *charging authority of state-owned enterprises (accounting information preparers)*, etc. There seem to be no radical conflicts between these three parties in China, since they are represented by the same authority. The national benefit agrees with benefits of most companies/enterprises (state-owned), since the State is the biggest investor of the enterprises. Thus, we do not

think that issues regarding standard setting really matter to the managers of the enterprises. They do appear not to be as positive as their American colleagues in participating the standard setting. Plausibly, the voice of the government is the highest during the standard-setting process, and the parties involved are quite few and thus insignificant.

Nevertheless, we think that minority interested parties may also be affected by the accounting standards setting in China, and their positions are becoming more and more important. Since the Chinese capital market is developing, companies are not only listed in the domestic stock exchanges, but also listed overseas. The state-owned enterprises are staying in their “corporatization” processes, they are encouraged and have as a priority to be listed in the market, meaning that the state will not be their only owner any more. Foreign direct investments in China are booming further, and these foreign investors’ power can not be underestimated. Thus, in our opinions, the interests of all these parties need to be cared for more and further taken into MOF’s consideration in China’s accounting standard setting.

2.3.2 Valuation rules comparison between China and the IASC

As mentioned, the Chinese ASBE promulgated by the MOF can only be seen as an accounting “conceptual framework” which is similar to those normally set in the western countries’ accounting concepts. When comparing the Chinese accounting standards with the IAS, we will use the Chinese specific accounting standards and those exposure drafts as parameters. Even though, as mentioned, there are only eight specific accounting standards that have been formally promulgated among 30 exposure drafts, and the remaining 22 standards are still kept on being discussed, we think they have compatibility for a comparison. We have included the comparison of specific accounting standards in a table, which is attached as Appendix 3 in the last page of the thesis. The information is quoted from those published in the IASC’s website (www.iasc.org.uk) and those discussed in Liu’s book (1996, p.276-281, in Chinese).

2.3.2.1 A comparison between Chinese accounting standards and the IAS

By comparing the Chinese accounting standards and the IASs, generally speaking, the Chinese accounting standards are very much closed to the IASs. The comparison has demonstrated the logic of our study that the Chinese current IAS-based accounting approximately equals the IAS. This point of view of ours has actually been running through the whole essay.

However, one can not ignore the fact that some distinctions also exist. Since, even though China is adopting a new accounting system, which is getting in line with the IAS, it is not a wholesale adoption anyway as in some countries. This means that China's accounting reform has its own features, which are mirrored and fit its special economy environment. These viewpoints of ours can be supported by the following findings:

The IASC has promulgated 39 accounting standards, among which, 5 standards have been replaced. In China, as mentioned, among those 30 inquiring exposure drafts, only 8 have been formally issued as specific accounting standards, the remaining 22 (in order for easy description, hereinafter they are also referred to standards) are still on discussion. Between these two sets of accounting standards, one can see that 23 standards are basically compatible. In the mean time, each set has its own unique standards. For example, there are 11 standards of the IASs that China has not yet been specifically dealt with. They are, Depreciation accounting of IAS4, Segment reporting of IAS14, Information reflecting the effects of changing prices of IAS15, Accounting for investments in associates of IAS28, Financial reporting in hyperinflationary economies of IAS29, Financial reporting of interests in joint ventures of IAS31, Financial instruments: disclosure and presentation of IAS32, Earnings per share of IAS33, Interim financial reporting of IAS34, Discontinuing operations of IAS35, and Impairment of assets of IAS36. Meanwhile, China has 5 standards which do not exist in the IAS, such as, Debt restructuring of

ASBE4, Receivables of IED1, Payables of IED2, Deferred assets of IED15, Liquidation of IED26. We think that one of the main reasons for these disparities is probably a result from the different accounting environments within which the accounting standards are formulated and applied. For example, during the corporatization of the Chinese state-owned enterprises, debt restructuring becomes a more frequent problem confronting the enterprises. Since Chinese stock market is still very young and underdeveloped, the matters involved in advanced transactions, such as financial instruments, are still very limited in the market. This has not required more concern from the government. Consequently, there are no concurrent standards formulated.

Additionally, dissimilarities also exist in those close-looking standards. For example, compared with IAS1 concerning presentation of financial statements, the Chinese standards do not require a statement to show changes in equity. Compared with IAS39 concerning financial instruments, China's IED28 only deals with futures. In China, "net profit or loss for the period", and "accounting for investments in subsidiaries" has not been dealt with as specific accounting standards, even though, they might have been mentioned as some parts included in some other standards.

Among the compatible standards, the corresponding requirements in China's standards are almost the same as those stated in the IAS. However, one can still see some small differences, such as when evaluating inventory (in IED3), China seems leave more alternatives to companies than the IASC. There is a few more valuation methods for inventory allowed to be used in China compared with IAS2. The same characteristics can also be found in some other Chinese accounting standards. For example, diversified depreciation methods are allowed when accounting for fixed assets (in IED8) compared with IAS16.

Comparatively, a prescription concerning the Chinese social welfare system does seem not sound enough as it is described in the IAS as there

are fewer benefits found in its IED22 of employee benefits than those disclosed in IAS 19. For example, only social insurance for employees and reserved funds for housing has been mentioned. It implies a rather simple accounting treatment compared with the IAS and corresponding standards in other Western countries. “In order to take concerted action with implementation of China’s social security system, the MOF should devote themselves more into pension accounting area” (Qu, 1999, p.23).

The Chinese features accounting can be reflected in some standards, for example, the requirement in ASBE, “disclosure of related party relationships and transactions”. It states that state-controlled enterprises should not be regarded as related parties normally. As the MOF (1999, p. 79) explained, it is “simply because they are subject to control for the State”.

It has also been noted that one of the obvious differences between Chinese accounting standards adopted and the International Accounting Standards is extend to adopt the prudence concept, or principle of conservation. China has adopted this principle only on a limited basis. For example, anticipated or unrealized losses are not provided for.

2.3.2.2 Implications from the comparison

A Tax-oriented accounting

It is stated by the Revised Accounting System that when there is a conflict between the treatments it prescribes, and the treatments stipulated by the relevant tax regulations, the companies should adopt the Revised System’s treatments for accounting purposes and follow tax regulations in determining taxable profits. Therefore, one can see that though Chinese accounting standards are gradually coming into line with IAS, they continue to serve first the requirements of the Chinese central and local government tax authorities. “In general, companies in China have traditionally viewed the filing of accounts as inseparable from the filing of annual tax returns. As a result, most financial reporting is geared up solely

to this end, unless the enterprise has an obligation to file returns on IAS, US GAAP, or other standards because it is listed on a stock exchange overseas” (Jones, 1997).

Since a primary purpose of accounting reporting is serving for the tax authorities, the government takes more concerns in their fiscal revenue. This results in reluctance for the Chinese accounting to adopt the “prudence principle”. It can be found in ASBE5 concerning revenue, where bad debt recognition has not been mentioned at all. The findings in IED 29 of enterprise combination also support this viewpoint. The amortization period for good will is 10 years compared to “5 years” required in IAS 22. It might be more apparently reflected in the eight issued specific accounting standards, which are mainly about things concerning in normalizing disclosure of financial information in capital market, i.e. those accounting matters in securing quality of financial information. A researcher (Qu, 1999, p. 17) comments, “Certainly, promulgation and implementation of these kind of specific accounting standards will not directly impact on and national financial revenue and financial power of enterprises”.

A less conservative accounting affecting the listings’ disclosure

Regarding the above-mentioned characteristic of China’s reluctance in adopting the “prudence principle” of accounting, some evidences can also be found in companies’ reporting practice. In China, the listed companies are required to disclose the relative information in special newspapers which are specialized by the Chinese Security Regulatory Committee (CSRC), such as, Securities Times, China Securities, Shanghai Securities, etc. Normally, this is the only source for an external interest party to search for the information of the listed companies, such as annual report. According to 98 annual reports disclosed in Securities Times (<http://www.securitiestimes.com>), both A-shares and B-shares issuing companies, Shenzhen Huafa Electronics Co. Ltd. (SHEC), and China Merchants Shekou Port Service Co. Ltd. (CMSPSC), have their different

accounting figures adjusted according to the Chinese GAAP and the IAS. The reason is that it is legally required for Chinese listing companies issuing both A-shares and B-shares to prepare their financial reports according to different accounting standards.

The net profit of SHEC according to the Chinese GAAP was minus RMB 52 million, after being adjusted by IAS, it dropped by 87% to minus RMB 97 million. The same goes for CMSPSC, whose net profit for 1998 according to the Chinese GAAP was RMB 114 million, after being adjusted by IAS, it decreased by 38% to RMB 71 million. The main causes were the different accounting treatments on those accounts dealing with provisions and investment income between the Chinese GAAP and the IAS. Such as, adjustment to deferred assets, adjustment to fixed assets, adjustments to allowance of bad debts for receivables, etc.

Evidence can also be found in the findings of some researches about Chinese B-share market from 1993-1997 (Chen, Gul, Su, 1999). It is suggested that reported accounting earnings based on the current Chinese GAAP are significantly different from those based on the IAS. On an average, the reported earnings determined under the Chinese GAAP are 20-30 percent higher than earnings reported under the IAS. After restatement, 15 percent of the B-share companies changed from a reported profit to a reported loss. The research indicates that compared with the IAS, the Chinese GAAP tends to be significantly less conservative, resulting in earnings that are significantly higher than those based on the IAS. One of the reasons could be that the primary objective of financial rules is to clearly define the scope and content of revenue, cost and expense so that the State is able to maintain a desirable level of tax revenue. The government must carefully consider its revenue needs before it introduces any change to the existing financial rules. However, their recent analysis of promulgated accounting standards indicates that the difference between the two sets of accounting earnings was likely to be significantly reduced after 1998, when the MOF promulgated "The Revised Accounting System for

Limited Companies”, which is one branch of the ASBE for different industries and was effective on January 1, 1998.

Thus, one can see that the features of China’s security market have influenced the way of information disclosure of those listing companies. That is, different share-issuing companies need to disclose their financial statements under different sets of accounting standards. We should say that it somewhat affects accounting information users to appropriately interpret the companies’ financial statements and accurately evaluate the companies, even though, the scope of disclosures for companies listed in Chinese markets are found to be increasingly comparable to those required by IAS. Some researchers (Chen, Gul, Su, 1999) comment, “the absence of detailed requirements and clear specifications for disclosures has adversely affected the effectiveness of financial disclosures. Further reduction in the differences between the two sets of accounting standards will largely rely on changes outside Chinese GAAP ”. They then suggest, “reform of financial rules and closer monitoring by the relevant authorities to reduce opportunistic application of GAAP are two sources that could help reduce the differences”.

Also, to solve the above puzzle, we think that some experiences of other countries or regions in establishing their national accounting standards may be worthy taking as reference. According to an investigation conducted by the IASC concerning 67 countries’ or regions’ treatments to using the IAS (Wang, 1999), 7 countries or regions, such as Australia, Denmark, Hong Kong of China, Italy, New Zealand, Sweden, and Yugoslavia, have set up their own national accounting standards, but in most circumstances, it is based on or similar to the IAS. Also, some standards have more alternatives in comparison with the IAS. Furthermore, there is an illustration listed behind each domestic accounting standard to compare it with the corresponding IAS. We think these countries’ experiences are quite worthwhile to be taken for setting China’s accounting standard.

Standards reflecting the state-controlled nature

Although Chinese accounting standards are established based on the IAS. Chinese features are still maintained to some extent. These reflect the socialist economy in nature, which are characterized by the state ownership. According to Ajay & Wang (1995), even after the recent reforms that have moved the Chinese accounting practices closer to International Accounting Standards, a number of accounting practices that reflect the state-controlled nature of the Chinese economy remain. Depreciation accounting, the rates to provide for provisions for bad debts and the exchange rates to be used to convert foreign currency transactions are all mandated by state regulations. These rates are unrealistic and have to be adjusted when converting Chinese financial statements to international standards. Inventory and short-term investments are carried at cost with no provision for losses due to a decline in value. Deferred taxation and contingent liabilities are not covered in Chinese accounting regulations. Reflecting the socialist economic and political system, Chinese enterprises are required to make significant provisions for staff welfare expenses, housing, pensions, bonuses, etc. Contrary to IAS, a portion of the provision is appropriated from after-tax profit rather than being expensed.

2.3.3 Disclosure comparison between the U.S. and China

We have listed most of captions in disclosure requirements in annual reports in the Form 10-K of the SEC and in the Content and Format of the CSRC. The whole Content and Format of the CSRC is in six A4 pages originally and mainly comprised of captions and no references. Nevertheless, the Form 10-K is very lengthy and full of references. For instance, Item 1 “Business” refers to Item 101 of the Regulation S-K. Financial statement requirements refer to the Chapter 210 of Regulation S-X. Furthermore, sub-captions and items are used for the application in specific situations. At the same time, explanations and instructions define each item and sub-item.

Because the disclosure requirements in China are to a large extent reprinted from the Regulation S-X and S-K of the SEC, a number of similarities exist. But, if one only compares the content under each caption, it is not difficult to find out that the regulations of the SEC are in great detail and thorough in contrast with those of the CSRC. This may be a reflection that the U.S. securities markets have developed to a very sophisticated stage nowadays, its accounting information disclosure requirements are very user-oriented. Because a variety of users either domestically or foreign have diversified demands to the information, which impels the reports to be prepared more thorough and transparent. The China securities market, on the contrary, only steps on a primary level. These differences in information disclosure requirements are inevitable.

The disclosure requirements of the SEC are more detailed and specific and allow less scope for judgement by companies (Benston, 1976, p.41). By contrast, the requirements of the CSRC seem to be too simple and less thorough. Take “Business” as an example, that which is prescribed by the Content and Format – Annual Report of the CSRC are matters with respect to the name, legal person, secretary to the board of directors, registration places of the company, bourse for trading of stocks, business operations within the period of annual report and so on in several lines. However, the same caption “Business” under the Regulation S-K contains at least seven to eight pages point for point, from general development of business, financial information about segments, financial information about geographic area and narrative description of businesses to reports to security holders and enforceability of civil liabilities against foreign persons. Another example is that both the SEC and the CSRC call for financial statement disclosure. The SEC refers to the requirements to Regulations S-X that are as extensive as possible. But, the CSRC states that the financial statement should obey the relative policies and regulations of the State and be attached with the annual report. The financial statement should include the consolidated balance sheet, the consolidated statement of income, a cash flow statement, and changes in stockholders’ equity,

value-added tax statement, assets statement, and segmental operating profit. As to the references to find content and form in preparing these statements, the CSRC does not mention.

On the other hand, we observe that the securities market of China is underdeveloped. Certain items required by the SEC are not shown in the Content and Format by the CSRC, such as the use of market risk instruments. Therefore, the item “Quantitative and qualitative disclosures about market risk” is not displayed in disclosure requirements in China. Also, under the item “Selected financial data”, the CSRC requires very basic data, for example, net sales or operating revenues, income (loss) from continuing operations, total assets, long-term liabilities, and stockholder’s equity. In contrast, the SEC includes much more profound data, such as capital leases, redeemable preferred stock, and cash dividends declared per common share. This situation agrees with the primary stage of Chinese securities market. A number of business activities have not emerged in the market.

Besides fewer requirements in information disclosure and the underdevelopment of the Chinese securities market, the disclosure requirements reveal that they have a deficiency on their own. There are some items that should have been included in the scope of disclosure requirements in China, for example, inflation disclosure. Dated back to the early 1990s, the inflation rate was more than 10 percent in China. Under such a circumstance, if an annual report misses to disclose inflation information and its effect to a company’s net sales and revenues, the degree of annual report credibility will be discounted. One may argue that maybe the inflation is treated as a significant event for a company and would be disclosed as a material matter in either periodic reports or current reports by the company. For it indeed, influences the company’s revenue and misleads information users to an untrue view of the company. However, we think it is such a material event that can not be ignored. Nevertheless, it’s not always the case. As a matter as fact, some companies omitted this

impact and showed it neither in their annual reports nor in current reports at all. Differently, the SEC requests to report three recent years inflation and changing prices on a company's net sales and revenues and on income from continuing operations under the item "Management's discussion and analysis of financial condition and results of operation", which precludes the possibility to neglect from disclosing.

In general, the requirements of Chinese accounting information disclosure are very simple and rudimental in comparison with those of the U.S. This is a reflection that the securities market in China is less mature and less complex. "The predominant influence of securities markets and their regulatory bodies in determining the quality and quantity of publicly available information in corporate reports is reflected in the strong correlation between well-developed markets and the degree of financial disclosure in corporate reports. Countries with active and well-developed markets generally have a greater degree of public financial disclosure than those with relatively less-developed markets." (Radebaugh and Gray, 1997, p.55). In addition, the securities market itself stays at an underdeveloped stage. A number of economic activities have not evolved in the current China market economy.

CHAPTER 3

ACCOUNTING ENVIRONMENT

3.1 Chinese accounting environment

In the proceeding sections, we have overviewed the development of China's accounting, from its accounting reform in history to the establishment of today's new IAS-based system. At the same time, we have also tried to give some insight into this new accounting system based on a comparison between China's accounting and that of other countries, especially with the IASC, and the FASB of the U.S. One may say that, in principle, based on the experiences drawn from abroad, China has an accounting system harmonized under the IAS, but, does it have an appropriate environment to implement this new accounting system? This will be our main concern in the following parts.

Just as mentioned, one of the most important factors affecting China's accounting reforms is the development of China's stock market, so it affects Chinese accounting standards significantly. Some questions may then be raised, such as, what does China's stock market look like? Is the environment of China's securities market mature and developed enough to appropriately apply the Chinese new IAS-based accounting system? Departing from these thoughts, we will present the following sections about the situation of China's stock market.

3.1.1 The emergence of Chin's a stock market and its evolvement

Prior to 1978, all enterprises in China were either state or collectively owned. There was little emphasis placed on measuring the profitability or the long-term viability of enterprises. These enterprises are state ownership

and experience mainly central government planning and price controls. Since 1978, as the Chinese economy has undergone a transition from a command control economy to a market-oriented economy, the stranglehold of state-owned enterprises has been substantially reduced. The State encouraged the non-state sector--collective enterprises and privately owned enterprises to grow. This regime gave township and village enterprises (TVEs) a take-off. Lin, in his article, attributes that China's market economy was created by the growth of TVEs, which were state-led through the industrial policies of local governments. (Lin, 1995). From a certain perspective, this opinion is correct. Because the growth the TVEs began to compete away scarce resources and state turnkey investment projects from SOEs. They cast a shadow on SOEs and made SOEs become increasingly non-competitive both on the domestic and international markets. Also, because most of the SOEs had outmoded technology and operated in a low efficient manner.

Due to a self-deficiency in management and organization structure, the harsh competition with collective and private enterprises, especially TVEs, and less and less subsidy provided from the State, SOEs faced the problem of finance. It is not uncommon for a country or a company to raise capital from markets in Western. The opening of the Shanghai Security Exchange (SSE) and the Shenzhen Security Exchange (SZSE) at the end of 1990 marked that a further reform within SOEs had been set off from financial sector. By listing on stock exchanges, SOEs would be able to attract domestic and foreign capital, gain access to foreign technology, and adopt international accounting and management practices.

China had securities markets dated back to the early 1900s and the issuance of stocks was much earlier back to the last century. In the 1930s, there was prosperity once in the securities markets in China. After the foundation of the People's Republic of China in 1949, securities markets were abolished. It took nearly four decades before China reopened securities markets with the issuance of central government treasure bonds (T-bonds) in 1981.

Treasury bonds were apportioned to public enterprises but were not allowed to circulate or transfer between individuals (Blake and Gao 1995). Three years later, a few enterprises in several big coastal cities, like Shanghai, Beijing, and Shenzhen, started to issue stocks and bonds. At that time, they were made over a bank counter rather than a stock exchange. The first publicly issued stock—for Beijing's Tianqiao Department Store—in September 1984 actually resembled a bond issue as the shares paid interest and were issued for a three-year period. This was first time allowed by the State for individual T-bond owners to sell their holdings to the State banks. Unlike a bond issue, though, the interest rate was not fixed (Chen and Thomas, 1997). When bond transactions between individuals were made possible between individuals in Shenyang (Jilin Province) in 1986, it symbolized the rebirth of securities markets in China (Blake and Gao, 1995 p.76). Other cities emulated the example of Shenyang and set up securities markets subsequently.

With an approval of the State Council at the end of 1990, the Shanghai Security Exchange (SHSE) was opened on December 19, 1990 and the Shenzhen Security Exchange (SZSE) was opened on December 1, 1990. Following the Shanghai and Shenzhen, twenty-four other cities had opened regional trading floors. Securities markets boomed with a lightening speed all over China. From then on, securities trading was getting accustomed and popular to people's daily life. The information such as securities prices and commentary of certain securities can be easily accessed from TV, radio, or newspaper.

Both the SHSE and the SZSE are a nonprofit membership institutions and legal persons. Their operations are under the supervision of the China Securities Regulatory Commission (CSRC). The SHSE assigned its wholly owned subsidiary, Shanghai Securities Central Registration & Settlement Co., for central registration, custody, management, and settlement of securities. The Shenzhen Securities Settlement Company, as an entirely

owned subsidiary, is responsible for the registration, custody, and settlement of shares listed on the SZSE.

By the end of 1998, 851 companies listed in the SSE and the SZSE with 252.677 billion shares. Of them, issuing A-share companies are 727, B-share 26, issuing both A- and B-share companies are 80, and both A- and H-share companies 18. The total market capitalization was RMB 1.95 trillion (USD 233.6 billion), equivalent to 24.46 percent of the gross domestic production (GDP). The total market capitalization of tradable shares was RMB 574.5 billion (USD 68.8 billion), 7.2 percent of GDP and the annual turnover was RMB 2.35 trillion (USD 281 billion) in 1998. Compared with the burgeon period of China securities markets nine years earlier when only 10 companies were listed. No matter how many companies were listed in the securities markets, 35 companies issued A-shares and 18 companies issued both A- and B-shares in 1992, nor that the total market capitalization RMB 105 billion (USD 12.56 billion), was equivalent to 3.93 percent of GDP and the annual turnover in amount to RMB 68.1 billion (USD 8.14 billion) in that year, China vertically jumped forwards towards a market economy. This situation can be portrayed as follows:

**Table 3.1.1 Stock Market and National Economy
(in billions of RMB)**

	GDP	Market Capitalization		Market Capitalization of Tradable Shares	
		Amount	over GDP	Amount	over GDP
1992	2,6638	0,1048	3,93%	N/A	N/A
1993	3,4634	0,3531	10,20%	N/A	N/A
1994	4,6759	0,3691	7,89%	0,0965	2,06%
1995	5,8478	0,3474	5,94%	0,0938	1,60%
1996	6,7885	0,9842	14,50%	0,2867	4,22%
1997	7,4772	1,7529	23,44%	0,5204	6,96%
1998	7,9748	1,9506	24,46%	0,5745	7,20%

Source: <http://csrc.gov.cn>

Even though the Shanghai and Shenzhen Stock Exchanges have almost the same length of history, the pace of development and sizes are different. Until recently, the Shanghai Exchange is about twice the size of the Shenzhen exchange, but it is only about 20 percent larger in terms of market capitalization. The companies listed on the Shanghai Exchange are mainly medium-sized SOEs from the Shanghai industrial region. This is because Shanghai, as known, has a leading position in light industry in China. On the other hand, compared with Shenzhen, it is geographically closer to the central government Beijing. Therefore, the Shanghai Exchange represents a more national market. The sizes of companies listed on the Shenzhen exchange, however, are smaller than on Shanghai. These companies mostly engage in real estate and a large number of them are located around the Shenzhen Special Economic Zone near Hong Kong.

3.1.2 Equity structure and securities types

In China, shares are divided into two broad categories: untradable and tradable. Under the category of untradable shares, there are three classifications: sponsor shares which includes government owned,

domestic legal persons owned, and shares owned by others, shares placed with legal persons (promoters), shares owned by employees, and other shares. It is noted that the State often acts as a promoter (either directly or indirectly through other SOE's control). Tradable shares are comprised of A-, B-, and H-shares (including all shares listed overseas, such as N- and S-shares, etc., which will be mentioned later). By the end of April 1999, the sum of untradable shares of listed companies was RMB 170.43 billion (USD 20.41 billion), or 66 percent of the total shares. Among them, shares owned by the government were RMB 88.89 billion (USD 10.65 billion), shares owned by legal persons were RMB 73.36 billion (USD 8.78 billion), shares owned by employees were RMB 4.97 billion (USD 595.21 million), and others were RMB 3.2 billion (USD 383.23 million). Percentages of these four sections in total shares were 34%, 28%, 2%, and 1% respectively. Tradable shares accounted for 34 percent of the total shares, to the amount of RMB 88.70 billion, of which A-, B-, and H-shares were 24%, 5%, and 5% of the total shares in each. The following table illustrates the share structure of Chinese listed companies:

Table 3.1.2 Share Structure of Chinese Listed Companies

	No. of Shares	Percentage of Untradable Shares	Percentage of Tradable Shares	Percentage of Total Shares
Untradable Shares				
Sponsor Shares:	146 504 684 777	86%		57%
- Owned by Government	88 890 146 151	52%		34%
- Owned by Domestic Legal Persons	53 872 476 919	32%		21%
- Owned by Foreign Legal Persons	3 742 061 707	2%		1%
- Owned by Others	-	-		0%
Shares Placed to Legal Persons	15 750 719 881	9%		6%
Shares Owned by Employees	4 969 422 782	3%		2%
Others	3 206 042 299	2%		1%
Sub Total	170 430 869 739	100%		
Tradable Shares				
A Shares	63 113 641 636		71%	24%
B Shares	13 595 475 895		15%	5%
H Shares	11 994 656 000		14%	5%
Others	-		0%	0%
Sub Total	88 703 773 531		100%	34%
Total	259 134 643 270			100%

Sources: As of 12\31\98. <http://csrc.gov.cn>

3.1.2 1 Domestic listings

An A-share is the most common and weighs heavier in proportion to all kinds of shares in China. It is denominated in the local currency (Renminbi or RMB). Companies issuing A-share register and trade in China. They are available exclusively to Chinese citizens. By the end of April 1999, both SSE and SZSE had tradable A-share in total 63.11 billion, or 71 percent of

total tradable shares and a market capitalization of RMB 169.90 billion (USD 20.35 billion).

A B-share is known as a Renminbi Special Share. It is a foreign-invested share issued domestically by Chinese companies. A B-share is issued in the form of a registered share and carries a face value denominated in Renminbi. It is priced in US dollars in Shanghai and in Hong Kong dollars in Shenzhen exchange for subscription and trading. B-shares should be listed and traded in securities exchanges inside China. B-shares are available restrictedly for the individuals who are foreigners, the people of Hong Kong, Macao, Taiwan, and Chinese who have a permanent residence in foreign countries and are reserved for institutions.

3.1.2.2 Overseas listings

Stocks issued by companies registered in Mainland China and traded on the Hong Kong Stock Exchange are called H-shares. Likewise, stocks listed on the New York Stock Exchange are called N-shares. S-shares are quoted on the Singapore Stock Exchange. In April 1998, 43 companies listed overseas, raising more than USD 10 billion and total number of H shares (including H-, N-, and S-share) were 12 billion.

Red Chips called by Hong Kong media, are stocks for Chinese companies quoted in Hong Kong and their headquarters are also registered in Hong Kong (usually owned by Chinese interests).

3.1.3 The requirements for a company to be listed on China's Stock Markets

According to the Company Law and the Temporary Statute for Stock Issuance and Trade Administration of China, limited liability companies must meet several requirements in order to be listed. First of all, securities must be approved by the China Securities Regulatory Commission directed by the State Council. Second, the share capital of a company should not be less than RMB 50 million (USD 6 million). Third, the company should be

profitable in three successive years, however, if a holding company is set up through restructuring from a predecessor SOE or major promoters of this holding company is SOE, the successive three year's term could be dated back to the profitable time of its predecessor SOE. Fourth, the stockholders who own securities to the amount of over RMB 1,000 (USD 120) should not be less than 1,000 in number. The tradable securities should be more than 25% of the total securities of the company. If the holding company has a total stock capital of more than RMB 400 million (USD 48 million), then the percentage of tradable securities might be reduced and to a lowest rate of 15%. Fifth, the company should have no broken law behavior in the last three years and its financial reports should not contain faked records. Lastly, the company should comply with other regulations made by the State Council.

3.1.4 Corporatizing state-owned enterprises

Due to the old planning economy system, most of enterprises are still owned by the State in China. "Decisions on current input and output choices as well as investment were made at either the central or the local government level and were conveyed to individual enterprises in the form of detailed obligatory targets and rules. Individual enterprises had very little discretionary power within the constraints imposed from above." (Chai, 1997 p.51). State-owned means that the State empowers a bundle of rights to an agent to exercise over an asset or a piece of property (Walder, 1996). This agent is normally designated by the State, who practices not only the ownership of the enterprise, but also the management right. So the ownership and management right do not have a distinct dividing line in a Chinese SOE. Dictated by this understanding of ownership, a manager or director has a right to dispose of assets or property on behalf of the State.

The emergence and growth of securities markets are one of the most important factors, which undoubtedly compel China to change its central planning economy to a socialist market economy. Like Radebaugh and Gray stated, securities markets are seen to be fundamental elements for the

transition to a market economy, which necessarily involve the privatization of state-owned enterprises and the need to attract foreign investment (Radebaugh and Gray, 1997, p.51). At the same time, most of state-owned enterprises innate outgrew with a planning economy and had deficiencies in the structure of assets, accounting systems, and organization structures. To adapt the market economy, the Chinese SOEs undergo a restructure so as to meet requirements for listing in securities market.

There are three types of restructuring methods for the SOEs. First, a SOE is reorganized directly into a shareholding company. This method is applicable to the SOEs, which have a reasonable economic index and would be listed with less changes in the company itself. In the meanwhile, the history of this SOE is relatively short. After the reorganization, a large percentage of shares are still owned by the State, as a legal person, and the employees of this enterprise. Second, a new shareholding company is derived from the SOE with its best part of the domain business operating assets. The preceding SOE becomes the parent holding company of this new company. This type of restructuring is the most common for the SOEs in China now. Normally, a majority of shares are owned by the State in this kind of shareholding company and the relationship of the new company with the parent company is very close. The last method that is a shareholding company is composed by several SOEs as promoters with their partial assets, businesses, and capital or creditor's right. One or two of these SOEs own a majority of the shares in the new company. When one or two promoters with overwhelming shares restructure, the others obtain the shares of the new company by either transferring creditor's right to share capital or reinvesting their partial capital, businesses and intangible assets or creditor's right into the new company. As a consequence, the new company has more or less contact with the preceding SOEs in these three methods. In particular, the organization structure of the new company is akin to the previous SOE. The representative of a listing company's legal person is the president of new company, who plays the role as a general manager as well in some of the listing companies. They are either from the

board of director, or appointed by the holding group, or assigned by the upper leading department of the State. The real control rights are still in the hand of the State.

3.1.5 China Securities Regulatory Commission (CSRC)

To adapt to the development of securities markets, the State Council Securities Commission (SCSC) and the China Securities Regulatory Commission (CSRC) were founded in October 1992. With the establishment of these two Commissions, a centralized market regulatory body was formed. The SCSC consisted of seven relevant government departments including People's Bank of China, the State Planning Commission, the Ministry of Finance, the State Commission for Restructuring the Economy, the Economic and Trade Office, and the State Administration of Taxation. Not only did the SCSC have the State authority to lay down the regulation for securities markets, but also these departments shared the regulatory powers with the SCSC. As the arm of the SCSC, the CSRC fell under the SCSC and was in charge of the supervision and regulation of the markets in accordance with the law. In November 1993, the State Council delegated the responsibility of the testing of the future market's operations to the SCSC, which was carried out by the CSRC before. In March 1995, the CSRC was approved to be categorized as a deputy-ministry rank unit under the State Council and the executive branch of the SCSC. In August 1997, the decision of the SHSE and SZSE to be controlled under the CSRC was made by the State Council. A year later, the authority to supervise the organizations engaging in securities by the People's Bank of China was transferred to the CSRC. Through these reforms in the securities regulatory structure, the power of the CSRC was gradually strengthened. To pursue the State Council Reform Plan in April 1998, the SCSC and the CSRC were merged to form one ministry rank unit directly under the State Council. After this merger, in September 1998, the State Council approved the Provisions regarding CSRC's Functions, Internal Structure and Personnel, which once again reassured the position of the CSRC as one of the enterprise units under the State Council and the

authorized department governing the securities and future markets in China.

3.1.5.1 The organization of the CSRC

The CSRC has one chairman who directs four vice-chairmen, one secretary general, and two deputy secretaries-general. It includes thirteen functional departments and offices, three subordinate centers, and one special committee, ten regional offices set up in key cities around the country and a missionary office in every province, autonomous region, cities directly under the jurisdiction of the State Council, and cities enjoying the provincial level status in the state economic plan.

3.1.5.2 Basic functions and responsibilities

The basic functions of the CSRC is to establish a centralized supervisory system and strengthen its supervision over securities markets, listed companies and securities related companies, and other intermediaries. In addition, to raise the standard of information disclosure and organize the drafting of laws and regulations for securities markets are the functions of the CSRC as well. The responsibilities of the CSRC are delegated to the thirteen individual functional departments. The CSRC is responsible for reviewing and censoring all sorts of reports concerning information disclosure. It determines and approves whether companies are qualified for listing and remaining as listed.

3.1.6 Legal works

As to the liabilities for a certified public accountant (CPA), both the People's Standing Committee of China (China's highest legislative authority) and the State Council have the legislation concerned. The Company Law (Rule 219) and the Chinese Certified Accountant Law (Rule 39) issued by the People's Standing Committee have similar regulations, which state that any agency that undertakes the business in assessing assets and examining capital and provides false verification documentation should be punished either by confiscating the outlaw incomes or by forfeiting in

amount of one time to a maximum five times of those incomes. The correlative administrative department has an obligation to discontinue the business operations of the agency and disbar the qualification of principal personnel based on the severity of situation. For a serious situation, the agency and its major functionary are liable for criminal liability. For the agency that omits material events in its assessment and examination reporting, a rectification is given. The agency will be fined from one time to three times for unlawful incomes that it earned from illegal operations. In the mean time, the Temporary Stature for Stock Issuance and Trade Administration (1993) (Rule 73) and the Temporary Methods for Prohibition Behavior in Securities Fraudulence (1993) (Rule 21 and 22) both released by the State Council have stipulations in the same area. Rule 73 and Rules 21 and 22 have a similar description in respect to this matter. These rules present if accounting firms, law firms, and assets assessment firms offer false and misleading information or omit the material events, they will be warned either jointly, with other liable parties, or individually, and confiscate illegal incomes and be fined on the ground of a particular situation. Depending on the severity of cases, their business operations would be suspended or even their permission for security related businesses would be disbarred. The punishment to the major CPA, assessment experts, and lawyers is either warning or forfeiting from RMB 30,000 (USD 3,593) to a maximum amount RMB 300,000 (USD 35,928). For a more serious situation caused by an agency's faults, their professional qualifications will be cancelled.

3.1.7 Accountancy in China

The professional standard of accountants and the number of professional accountants are far from satisfied in China nowadays. There are some historical reasons for this. As a socialist structure, the accounting objectives differ from those in the West, and the accounting systems developed to serve those ends also differ (Winkle, Huss, and Tang, 1998). The old-fashioned accounting system reflected the information needs of a planned economy. Based on this guidance, accounting professions and

accounting education were influenced significantly by the central planning economy of the country. For example, in Chinese universities, finance economics and accounting program was highly specialized and often industry oriented. There were ten broad divisions within accounting: Accounting, Financial Accounting, Industrial Accounting, Agricultural Accounting, Commercial Accounting, Material Accounting, Management Accounting, Banking Accounting, Tourism Accounting and Petroleum Accounting. Within each of these were additional specialties. It was found that there were 80 different kinds of specialties in 1986. This classification was mainly designed to meet the needs of disaggregated information by the centralized planning system and line ministries. Meanwhile, the State adopted the Soviet Union's model of higher education at that time, which comprised of a number of highly specialized institutes. The purpose of this higher education model was to fill the needs of the planned economy as well (Winkle, Huss, and Tang, 1998). This type of accounting education programme setting sheds light on a lagging in Chinese accounting that is behind its Western counterpart.

With China's economic reform from central planning to a socialist market economy, which started in the late 1970s, the old accounting knowledge and practices become outmoded. The inflow of foreign investment including joint ventures and wholly foreign-owned enterprises, and experimental joint-stock companies brings in brand-new accounting practices. The work done by Chinese accountants is not acceptable for foreign countries, especially when a company wants to be listed overseas. For example, the companies must not be listed overseas unless their financial statements are audited by the Big Five accounting firms (Arthur Andersen, KPMG Peat Marwick, Ernst & Young, Deloitte & Touche, and Waterhouse & Coopers). As a consequence, a large number of accounting profession positions needed to be filled in.

The CPA regulations were first announced in 1918 by the Northern Warlords government. Three years later, the first Chinese CPA firm was

established in Beijing (Blake and Gao, 1995, p.63). It was not until in 1980 that the CPA system commenced to re-operate in China with an announcement of the Provisional Regulations on the Setting Up of an Accounting Consultancy released by the Ministry of Finance (MOF). In 1988, the Chinese Institute of Certified Public Accountants (CICPA) was established. It is under the jurisdiction of the MOF directly. The CICPA is responsible for all affairs relating to CPAs, such as the registration of CPAs and CPA firms, and CPA examinations.

From the time of setting the CPA system again in China, the numbers of CPAs have increased many-fold. Notwithstanding this significant growth in CPA teams, the demand for qualified CPAs still cannot be met within a short period. Of the seven million accounting staff currently employed in China, only around thirty thousand have experience in joint ventures, private enterprises, foreign enterprises, or CPA firms. However, it has been estimated that around three hundred thousand professionally qualified accountants will be required by the year 2000 if China's accounting needs are to be adequately served (Radebaugh and Gray, p.112).

Before the open door policy, the auditing practices were owned by the state and private individuals, and shortly thereafter were converted into SOEs (Blake and Gao, 1995, p.320). To adapt to the reform policy, the government approved a new Constitution of China to set up an Audit Administration in 1983. Various audit departments were gradually set up within the Administration, provinces, cities and self-governing areas.

3.1.8 The development of Chinese securities markets and its influence on accounting

The emergence and development of China's securities market do not only accommodate the evolution of the society, but also have a fundamental impact on the Chinese accounting regulations and ideology. These two interact and inter-condition. If there were no securities market, maybe China would still have kept a central planning economy. On the other hand,

securities markets require a series of accounting regulations to support its operating in a benign cycle. It is not surprising to observe the positive propel from securities market to Chinese accounting. Notably, after the emergence of securities market in 1980's, Chinese accounting has had a tremendous change to adapt to this new market.

3.1.8.1 The influence of early stock markets

The essential function of Chinese accounting was intended primarily to provide financial information and a reporting system for State economic policies and maintain administrative control over State assets. These rigid and uniform accounting rules also served as a tool to strengthen the financial discipline of enterprises and safeguard State property (Foley, 1998). From the first stock issued in the middle 1980s to the established Shanghai Stock Exchange at the end of 1990, the function of accounting had a fundamental change. Accounting, thereby, was a tool to provide financial information to the shareholders and potential stock investors. The change of the companies' ownership by all means altered the purpose of accounting. It technically supported the reform not only in China's shareholding companies but also to the establishment of modern enterprise systems, whose main earmark is the separation of ownership and management right in a corporation. At the same time, this shift in ownership contributed to the development of China's stock market. As a result, the managers, shareholders and stock investors of shareholding companies paid more attention on the function of the profit and loss statement instead of the previously applied balance sheet. Another reason which accounted for the preference to profit and loss statement was that a capital balance sheet (or a basic accounting equation: total fund application = total fund source) was popular and a basic accounting equation in the field of China accounting. It consisted of three sub-equations:

Fixed assets = Fixed funds

Current assets = Current funds

Specific assets = Specific funds

Nevertheless, such a type of balance sheet would not illustrate the property of shareholding companies correctly and its importance of course turned to be less. Consequently, the accounting practices of the shareholding companies emphasis was on revenue, costs and expenses, the recognition of profit and loss, and the method of the profit distribution.

3.1.8.2 The influence of bourses

The rebirth of China's two bourses gave a positive dynamic propel on accounting ideology. Since the date of the establishment, the Shanghai Stock Exchange emphasized the standardized accounting information disclosure for listed companies. At that time, there were eight companies listed on the Shanghai Bourse, the characteristics of their ownership were state-owned and collective owned respectively. They were in charged by seven administrative departments individually. In order to be listed, to a certain extent, they reformed to holding companies and named as shareholding. However, the accounting systems and methods they adopted were still state-owned and collective sector's accounting mechanisms. When these eight companies prepared for their financial reports, they acted up to the format for state-owned industrial, state-owned commercial, collective owned industrial, collective owned commercial, town and village owned enterprises respectively and the requirements of their own business administrative department. The comparability of these financial reports is imaginable though. These financial reports were not prepared in terms of the mandate of the holding enterprises and, therefore, worthless to be exposed to the public. After the opening several months later, the Shanghai bourse had to render some financial indices for the year of 1991 such as net profit per share and net asset per share to the public for these eight companies.

As the rapid development of the stock market and a sharp rise in the number of share investors in the early 1992, the dissatisfaction in the non-standardized accounting information disclosure of listed companies got stronger and stronger. Because the previous accounting system disclosed

only fund balances, it was hard for external users to trace assets, liabilities, the owner's equity, and profit and loss so as to appraise a stock. Under such a circumstance, the Shanghai Bourse invited teachers and master students from accounting departments of universities to make a conversion. They converted the diversified format and items in the 1992 annual reports of those eight companies to the unified format applied by the listed companies in other western countries in accordance with the same break-down and consolidated methods used internationally at that time. The shareholders gave a strong urge that China needed a set of accounting standards to be in concordance with the development of stock markets. Also accounting had to get rid of the shackle of business sectors' accounting that matched with the central planning economy in the past. Hence, a new accounting system should serve for the market economy instead. The previous traditional accounting mechanisms had lagged far behind the present economic environment. The Chinese accounting professionals realized the importance of comparability in accounting information from this conversion and embarked on a research and study in this new challenging field. In addition, the conversion provided a good experience to make a unified reporting format for the future. The Shanghai Bourse had an influence on accounting ideology in this period because it created a market economy accounting environment so that the accounting ideology could develop and go further in it.

Another contribution of the bourse was a confirmation of accounting equation:

$$\text{Assets} - \text{Liabilities} = \text{Equity}$$

Under the old accounting system, China had used the basic accounting equation as mentioned:

$$\text{Total fund application} = \text{Total fund source for years}$$

When making the conversion from capital balance sheets prepared by those eight companies in compliance with the business sectors to balance sheets, a rationality and understandability was exhibited by the accounting formula “Assets – Liabilities = Equity”. In turn, the rationality about the equation “total fund application = total fund source” was challenged. As to this dubiety, China’s accounting professionals had a debate. Finally, “Assets – Liabilities = Equity” was affirmed as the accounting formula which suited China’s situation. China has an ancient saying: Ducks are the first ones to know if the water of Chunjiang River is warm. Accountants of the listed companies and accounting professionals who served the listed companies adapted to this reform first. The information of the shareholders’ equity disclosed by the balance sheet not only benefited the shareholders in a holding company, but also made investors to realize the importance of financial information when they made investment decisions.

3.1.8.3 The influence of government regulations

The Accounting Regulations for Experimental Share Enterprises (ARESE) was the first nationwide administration legislative work about shareholding enterprise accounting regulations issued by the Ministry of Finance in July 1992. It adopts internationally accepted practices, although to varying degrees. Through an enforcement of the ARESE, all holding companies were commanded to exercise the new accounting practices rather than the old state-owned enterprise accounting system. By doing so, the latest accounting philosophy connected to the international practice was input to the accounting personnel of the holding companies, so this more or less upgraded the accounting professions to a step further. In the ARESE, it implied certain accounting assumptions and accounting principles, for instance the ARESE includes the accounting assumptions excluding the entity concept, such as continuity, periodicity, and money measurement. It also contains twelve principles: objectivity, relevance, comparability, timeliness, clarity, accruals, matching, prudence, historical cost, revenue and capital identification, comprehensiveness, and materiality (Blake and Gao, 1995). These accounting assumptions and principles later became the

blueprints of the Accounting Standard for Business Enterprises released by the MOF.

Another contribution by the issuance of ARESE was that the legalized use of the debit-credit method in bookkeeping became compulsorily. Since then it has ended a long-lasting debate about which was better, the debit-credit method and increase-decrease or receipt-disbursement double entry method in accounting bookkeeping. China had been using the increase-decrease method in small manufacturing enterprises, and the merchandising enterprises and receipt-disbursement double entry method in government agencies for the reason that they were easy to learn and to popularize. They were particularly promulgated to the height during the Culture Revolution. With the implementation of these two bookkeeping methods, more and more drawbacks were displayed, such as no clear relationships between increase-decrease accounts, obstacles in the communication of accounting information, confusion in accounting symbols, and difficulties in stating complex economic businesses exactly, etc. Since accounting should reflect the truth of business activities, and the increase-decrease or receipt-disbursement method is too simple to fulfil this function of accounting, it is reasonable to replace old methods with a more sophisticated bookkeeping.

With the development of the holding companies, the consolidated financial statements had to be dealt with by these companies. For this reason, the ARESE stipulates that if an enterprise owns more than 50 percent of another company, or owns less than 50 percent but has a significant control over this company, a consolidated statement should be prepared. Because the consolidation involved some unheard of concepts such as economic entity and problems like goodwill and so forth for most of Chinese accountants, it therefore freshened and gave an insight to the Chinese accounting ideology.

3.1.8.4 The influence of state-owned enterprises' reform

International accounting standards were bettered by the development of the market economic environment and several decades' gradual perfection of the environment. Similarly, the progress of China's accounting standards attributes to the rapid development of market economy. The more sophisticated and reasonable the accounting standards are, the maturer the market economy is. China has been attempting to reform its SOEs since the 1980s. Nevertheless, the fundamental malady exists in SOEs' structure. Without reforming the structure of SOEs, the other endeavor would have been in vain. In 1991, the Chinese government decided to make a fundamental change in SOEs' structure. Most of the SOEs had been or will be transformed to shareholding corporations. This reform in the SOEs manifested the separation of government influence and control from the management of the SOEs. The legal entities are responsible for their own decisions about operations and expansion and profits and losses. As the SOEs have gone through reestablishment and restructure before listing, they encounter the problem of evaluating the assets of the State. In the past, all assets were transferred from the state-owned or collectively owned enterprises, it was not necessary for accountants to assess the value of the assets. Due to the reform in shareholding corporations, the pricing for assets could not be treated as the method for gauging earnings any more. However, it should be regarded as a measurement for weighing a value.

3.2 The U.S. accounting environment

3.2.1 Introduction to the U.S. securities market

From the establishment of the first American stock market in the late eighteenth century, the U.S. securities markets have undergone a progress from an infant of yesterday to a grown-up of today. Experiencing more than two centuries evolvement, the U.S. securities markets have developed as the No. 1 market in a global range, up to date. The market capitalization amounted to USD 13.5 trillion in 1998. This figure represented almost half of the total global capitalization (USD 27.5 trillion) in the same year. Apart from the size of the securities market, the trading is also very active and

kinetic. The volume of the U.S. securities trading was USD 13.1 trillion in 1998, or 57 percent of the world trading volume (www.globalfindata.com). In 1998, 8,450 companies listed in the U.S. securities market. Notably, institutional investors are the major owners of shares in the U.S. For instance, up to 60-75 percent share ownership is dominated by institutional investor (Mallin and Xie, 1997). This market has already turned to be a most trusted and most stable one and it will continue to attract the major investors of the world (Brancato, 1996).

3.2.2 Holding Company

Corporations are not unfamiliar with the western world since the Romans used them from the fifteenth century. They were the products of the industrial revolution. In the nineteenth century, this form of organizing companies grew rapidly in western countries, particularly in the U.S. and the U.K. “The characteristic features of the corporation are its relatively long life (perpetual succession) and the transferability of its capital” (Most, 1977, p.43). These features of corporation determined the “use of the corporation as a device for channeling savings into business investment effected a separation between capital and its management, formal in the case of the ‘one man corporation,’ but very real in the case of those corporations which raised capital from a number of investors.” (Most, 1977, p. 43). Due to these advantages, the corporation trend inevitably spread all over the Western.

By the end of nineteenth century, a large number of corporations had developed to a certain extent so that they had surplus capital sources at hand. Some of this kind of corporations took over others by acquiring the shares of those corporations to become holding companies. These holding companies had distinctive characteristics of the modern shareholding companies, e.g. they were set up through issuing shares. They had legal persons and were managed by administrative personnel under the leadership of a board. A board meeting was the highest entitlement. These trading companies distributed interests according to the number of the

shares owned by the individual. Also, these companies exercised limited principles, issued stocks, allowed stocks to be transferable, and endowed the companies with a perpetual life. Up to the middle of the nineteenth century, shareholding companies accompanied the industrialization rampancy from Britain to other capitalistic countries. From then on, shareholding as one of the models of corporation spread through the entire capitalistic countries and penetrated the United States.

Hence, we could perceive that the holding companies were born in the capitalist society. Then, what is identified and termed as capitalism? Vernon Kam (1986, p.23) argued that private business entities that pursued profits are not enough to be termed as capitalism, even though the private ownership impenetrate the entire capitalist history. He stated in his Accounting Theory: “the focal point of this system is the market, which is self-regulated by a price mechanism made operative by supply and demand.” (Kam, 1986, p.23). By providing goods and services, each participant could run after his or her economic goals in this market. In doing so, the market is activated and “becomes competitive.” (Kam, 1986, p.23). The characteristics of capitalism are described by Sombart as profit making and economic rationality (Kam, 1986, p.23).

Because the form of corporations could channel savings into business investment and even raise capital from a number of investors, the corporation provides emerging entrepreneurs who do not have an easy access to capital or the opportunity to start a personal project. The capital providers (investors) become the owners of the corporation and they control the corporation through a system that a separation of ownership from management right. Together with market competitiveness mechanism, every participant pursues a goal for profits.

3.2.3 The Securities and Exchange Commission (SEC)

The securities markets are the dominant influence on accounting regulation in the United States. Due to a stock market crash in 1929 and subsequent

financial crises, which involved a large number of vulnerable public investors, the U.S. Congress sought securities regulations to resolve this dilemma (Radebaugh and Gray, p.88). Based on this concern, the Congress requested the New York Stock Exchange (NYSE) to conduct an investigation in 1933 and in early 1934, the outcome was the Securities Act of 1933 and the Securities Exchange Act of 1934. The Securities and Exchange Commission (SEC) was created by the 1934 Exchange Act.

SEC is an independent agency of the United States government. It was established with the legal authority to enforce the securities laws and also to formulate as well as to enforce accounting standards (Radebaugh and Gray, p.88). Neither Congress nor the executive branch directs or controls its operations. It has been given statutory power to administer and enforce all securities laws and has adopted a wide variety of methods for doing so. These security laws consist of Securities Act of 1933, Securities Exchange Act of 1934, Investment Company Act of 1940, Investment Adviser Act of 1940, Public Utility Holding Company Act of 1935, Trust Indenture Act of 1939. Among them, the 1933 act and 1934 act are the two most relevant acts to which accounting activities are related. Securities regulations are controlled by these two pieces of legislation. Both of them are Federal Laws. As to the methods, they range from gentle persuasion to the abilities to recommend criminal prosecution (Buckley, Buckley, and Plank, 1980, p.27-44).

The 1933 Act was intended to protect the public from fraudulent practices when purchasing and selling newly issued securities. It also requires the initial offering to be registered with the SEC. This act depicts both the civil liability and criminal liability for the person who fails to conform to its provisions. The 1934 Act set up reporting requirements for corporations offering securities for sale to the public. Corporations trading under this act should file periodic reports with the SEC and disclose material facts in proxy solicitations. Apart from these, the 1934 act establishes civil liability and criminal liability to restrict insider trading.

The SEC has five commissioners, who are appointed by the president of the U.S. and approved by the Senate. Also, the president designated one of them to chair the Commission. This person coordinates and oversees the operations of the SEC. The headquarters of the SEC is located in Washington, D.C., and its regional and branch offices lie on major financial centers in the U.S. The chief commissioner is assisted by a staff of professionals including accountants, engineers, lawyers, and securities analysts. These professionals are delegated to various divisions and regional offices. The chief accountant supervises the development of accounting policies, rules and regulations for the corporations. There are five divisions in the SEC where authorities are overlapping:

1. The Division of Market Regulation
2. The Division of Corporate Regulation
3. The Division of Investment Management
4. The Division of Corporation Finance
5. The Division of Enforcement

It is worth mentioning the Enforcement Division here. It reviews and supervises enforcement activities pursuant to securities laws. Enforcement activities are undertaken against a wide range of misconducts involving financial disclosure fraud. This division also supervises all investigations whether conducted by itself or by another division. It initiates administrative and injunctive actions. By collaborating with the Office of the General Counsel, who interprets statutes, reviews proposed forms and rules, and recommends specific provisions for the proposed legislation, they review recommendations for criminal prosecution by the Justice Department.

Legal works

The common law prescribes that the accountant is liable to clients and to third parties for fraud and negligence. Also, the accountants are liable to compensate in the U.S. for the damages caused by accountants' fraudulent

and negligent financial statements. The significant alternations of the common law, both the Securities Act of 1933 and the Exchange Act of 1934 are defined more specifically and detailed. Both of these acts attempt to ensure adequate information disclosure and contain provisions establishing civil liability and criminal liability for accountants who make false or misleading statements in any document required to be filed under the acts. The 1933 act set up civil liability under Section 11 for filing materially false and misleading information, and criminal liability under Section 17 for prohibited acts related to the issuing of securities. Under Section 11, the liability of accountants extends to any purchaser of securities relying on untruth or omission in the effective registration statement when purchasing. The injured investors may sue at law or in equity in federal court. The accountant is liable for damages suffered by a purchaser of securities either jointly, with other liable parties, or individually. That is, all liable parties must bear their share of compensation to the injured purchaser (Buckley, Buckley, and Plank, 1980, p. 69). The liability for paying damages can be very expensive. Section 17 and 24 each describe the liabilities of accountants for making false statements, failing to give material information, and failing to comply with the provisions of the act, and specific penalties such as a fine of up to USD 10,000, imprisonment for no more than five years, or both.

The Exchange Act contains Section 18 for civil liability and Section 10 for criminal liability against making false or misleading statements in any document required to be filed under the act by accountants, which mainly includes periodic reports and current reports, as well as financial statements.

3.2.4 Accountancy in the U.S.

In the U.S. and other western countries, the qualification of accountants is granted through tests. The American Institute of Accountants (AIA) was set up in 1916. It established a Board of Examiners in 1917 to create a uniform Certified Public Accountants (CPA) examination. In 1957, AIA was taken

over by the American Institute of Certified public Accountants (AICPA), which is a private sector organization.

The certified public accountants (CPA), who practice before the SEC, must conform with both the AICPA Code of Professional Ethics and SEC requirements (Buckley, Buckley, and Plank, 1980, p.215). The SEC regards the accountants' independence of the AICPA Code of Professional ethics as the most serious issue with respect to accounting information disclosure.

To be recognized as independent accountants by the SEC, a practitioner must be "duly registered and in good standing under the laws of the place of his residence or principal office" and "be independent" (www.sec.gov). In Regulation S-X (financial statement), the SEC articulates if this practitioner fails to meet either of the following conditions, he or she is not considered as being independent:

"1) during the period of his professional engagement to examine the financial statements being reported on or at the date of his report , he or his firm or a member thereof had, or was committed to acquire, and direct financial interest or any material indirect financial interest;

2) during the period of his professional engagement to examine the financial statements being reported on, at the date of his report or during the period covered by the financial statement, he or his firm or a member thereof was connected as a promoter, underwriter, voting trustee, director, officer, or employee." (www.sec.gov)

To sanction unlawful accountants, the SEC might either sue for the federal courts after obtaining criminal judgements or cancel the qualification by suspensions and disbarment. The specific liabilities for either civil or criminal prosecutions of the accountants may refer to the Securities Act of 1933 and the Securities Exchange Act of 1934.

3.3 Comparison of accounting environments

Compared with the U.S., the securities market in China has a short history –from the early 1990s to the present, only a decade. Not only in the size and maturity of the stock market does China’s market lag far behind its western counterpart. The total market capitalization of the securities markets was RMB 2.97 trillion (USD 355.69 billion) at the end of August 1999, equivalent to only 3.1 percent of the total capitalization of the U.S. at the same period.

3.3.1 The separation of ownership and management right

The holding corporations are established for the purpose of being listed in China, which started from the late 1980s. The form of corporation is a replica from the western world. The corporations are reestablished artificially by the State. Even though they are possessed of the structure of the corporation in the context of the U.S., for instance, the board of directors, the board meeting, general managers, and the supervisory board, in the main, the State is still the biggest investor and owner. With its overwhelming share ownership, the State delegates the president and general manager directly or indirectly to the corporation. The division line of the owner and control personnel of the corporation is really inexplicit.

In return, corporations have existed in the U.S. in the middle of the nineteenth century. They were formed in line with the needs for collecting spare capital in the market. The uprising of the legal person, the board meeting, the board of directors and so on consisted in the contemporary environment. Because the corporation could raise capital from a number of investors, and the goal for these investors was to pursue profits. Naturally, the investors as stockholders who own the property of the legal person-the corporation are separated from the management staff who operate the daily businesses for the corporation.

3.3.2 Legal works

The legal works in regulating the responsibilities of accountants and correlative securities agencies are dominated by too many regulators in China. Both the People's Standing Committee and the State Council have legal powers and enact rules in the case of delivering false and misleading information by accountants and agencies. Both authorities have different punishments for the same wrongdoing. The People's Standing Committee stipulates diversified treatments in providing misleading information and omitting significant events. The State Council just combines these two wrongdoings together and sets a unified treatment instead. (We could not figure out which rule or authority has priority depending on each case.)

By contrast, the 1933 Act and the Exchange Act are federal laws in nature. They are the significant alternations and complement to the common law. Both of them established civil and criminal liabilities to penalize the people for filing materially false or misleading information with the SEC. The 1933 Act concerned the truthfulness of quantity and quality of disclosure of information on new public offerings of securities. Any false or misleading information prepared by public accountants and others causes a damage to investors liable to a third party. The preparers are charged by investors with untrue statements filed with the SEC. Likewise, the 1934 Act establishes liability to investors for faked statements that were made in bad faith in certain documents filed with the SEC. Accountants involved in fraud are convicted guilty and liable to compensate the injured party as a result of the fraudulent statement.

3.3.3 Ownership

The ownership in the U.S. and China has a fundamental discrepancy. The U.S. has capitalist market economies, characterized as a private ownership. Most of the larger companies and many of the smaller ones are publicly owned by numerous individuals (Benston, 1976, p. 3). In contrast, China still requires "socialist public ownership of the means of production" in its constitution (Cooper and Zheng, 1998). At the national level, the State

Council — China’s cabinet — acts as the ultimate owner of SOEs on behalf of the Chinese people, with the National Administrative Bureau of State-Owned Property acting as an agent. Similar upper-tier bodies exist in provinces and cities. An intermediate tier is composed of provincial- and municipal-level holding enterprises — state asset operating companies. The SOEs belong to the third tier.

On the other hand, up to 60-75 percent shares are owned by institutional investors in the U.S. These institutional investors normally consist of commercial banks, pension foundation companies, and insurance companies, etc. They act as agents for sporadic individual clients and take advantage of their capabilities in collecting and analyzing information in order to achieve a maximum profitability in markets. But the ultimate investors are those clients who consign the institutional investors to make investments for them. From this standpoint, share ownership of a company is the public. Unlike the U.S., the share ownership structure in China is the State. Basically, the state, as the largest shareholder group, holds more than 60 percent of the shares (refer to the foregoing figures, *Share Structure of Listed Companies by the end of April 1999*).

3.3.4 Accountancy

Even though CPA regulations had appeared in 1918, this system was suspended after the Chinese Communist Party took over. It has not regained its operation until early 1980. The earliest CPC examination was launched in 1983. Because the open door policy brought in foreign investment including joint ventures and wholly foreign-owned enterprises, and experimental joint-stock companies, the traditional Chinese accounting ideology is not suitable any more, as western accounting philosophy is introduced into China. Accompanying the economic reform further on, the socialist market economy mechanism is affirmed, accordingly, the market economies’ accounting is imported from developed countries, especially the U.S. The change in social structure requires accounting education, practices, and the auditing system to be under reconstruction. Due to all

these occurrences in two decades, the accounting professions are in a scanty and low standard condition currently in China.

On the contrary, since the American Institute of Accountants (AIA) set up the Board of Examiners in 1917 and created a uniform Certified Public Accountants (CPA) examination, the accounting professions in the U.S. have undergone more than eighty years. The accounting professions are well trained and skillful.

The CSRC does not regulate the role of accountants in accounting information disclosure in the Content and Format. Furthermore, it does not include independence in the requirements of either periodic or current reports. However, the SEC explicitly states what is termed as independence for accountants in Regulation S-X. The financial statements are acceptable only for those prepared by independent accountants. By doing so, the true and fair view of financial statements can be met, which abides by the mechanism of market economy and assists a fair competition in resources. On the contrary, the CSRC does not command the independence of accountants, which seems to give a subterfuge if the accountants deliver untrue financial statements.

CHAPTER 4

DISCUSSION AND CONCLUSION

4.1 Discussion

4.1.1 Is the Chinese environment appropriate for the current accounting system?

As stated in the paper, the U.S. stock market is supposed to be a model of a well-developed market where stock market oriented accounting is prevailing. It is thus taken as a counterpart of China's stock market where an IAS-based accounting is applied. The logic bridged in between is that we assume these two sets of accounting of China and the U.S. are approximately the same. Since, through the comparison between China and the IASC, we have demonstrated that the Chinese current accounting system is almost a replica of the IAS, which is seen as preferable to the U.S principles, the SFAS. In other word, we may say that the Chinese current IAS-based accounting approximately equals to the SFAS too. Consequently it facilitates our discussion below.

Based on the proceeding stock market comparison between China and the U.S., we discussed following question is China's stock market an appropriate environment for its current IAS-based accounting system? It is conducted mainly from six aspects: the separation of ownership and management right, legal works, ownership, the accounting and auditing profession, influence of the company's management, and the independence of accounts and auditors.

4.1.1.1 The separation of ownership and management right

Under a fully mature market economy system, such as the U.S., the ownership and management right of a corporation are highly separated. Ownership stands for a right to utilize the asset (utilization right), possess

the responsibility for either profits or loss (return right), and transfer these rights to another agent through gift or sale (alienation right). As a result, the manager of corporations is not a real owner, they fill out the position as agents. Shareholders employ managers to look after their everyday business, and expect the managers to raise the share price of the corporations. The duty to select managers falls on boards of directors, who are elected by shareholders. The compensation in the presence of profit sharing and bonus of the managers is connected closely to share price performance and related indicators, and the influence of managerial reputation on the firm's cost of capital. To appoint or remove managers absolutely depends on the intention of shareholders. This sort of system not only makes a distinction in the right, responsibility, and liability of the owners from those of the managers, but also creates a high standard class of management — administrative class. The separation of ownership and control of corporations appears to have resulted from the emergence of professional management composed of individuals whose positions of power within corporations stemmed from their possession of administrative and/or technical skills rather than ownership of the corporation's capital (Radebaugh and Gray, 1997, p.51). The more successful a corporation is, the more important position the management personnel will be. Whether, and to what extent, the separation of ownership from management and the division of the corporation into two essentially distinct groups result in behavior different from that of a corporation owned and controlled by the same persons is a matter of considerable controversy (Radebaugh and Gray, 1997, p.51).

Accounting systems evolve from and reflect the environments they serve (Radebaugh and Gray, 1997, p.5). The accounting in the U.S. is no exception. The establishment of the FASB's accounting standards relies on an environment whose two rights are in the charged of different persons. In its environmental context of objectives, the FASB proposes that "since investor-owners are commonly more interested in returns from dividends and market price appreciation of their securities than in active participation

in directing corporate affairs, directors and professional managers commonly control enterprise resources and decide how those resources are allocated in enterprise operations. Management is accountable to owner-investors, both directly or through an elected board of directors, for planning and controlling enterprise operations in their interests...”(FASB).

In contrast, most of the shareholding companies in China fail to achieve these two rights separation through restructuring the preceding SOEs. The State maneuvers the majority shares’ ownership of the listed companies, the entitlement of the listed companies’ legal person and the senior management staff is decided by the State. Accordingly, the examination and evaluation of the performance of these personnel are done by the correlative department of the local communist party committee, which represents the State in nature. Thereby, a large number of listed companies have accomplished nothing in restructuring from state-owned enterprises to shareholding corporations except in titles of a management board and a name of limited liability corporation. Even though many of China’s SOEs have gone through a restructure process to become a holding corporation, the substantiality of the company remains the same as before. The corporation, in effect, is frequently managed by the same officials that were in place when the corporation was totally state-owned. So, the ownership and management right are still together in most shareholding corporations. Furthermore, the interests of the members of the board of directors who stand for the state-owned shares have little to do with the achievement in business operations and the dividends of the company. Under this circumstance, the concept of manager is confused with the one of owner. In addition, the highly centralized ownership of shares hampers the classification of responsibility between the two rights. There is no mechanism to oversee the performance of the management personnel, the imaginable outcome will turn out to be low efficiency and capital waste.

As stated, the IAS-based accounting standards are almost duplicated from the IAS, which is Anglo-Saxon oriented. It is supposed to be very intimate

to the U.S. accounting standards, SFASs, prescribed by the FASB. Then, the SFASs require a two rights' separation environment, in turn, is China capable to provide such an environment for IAS-based accounting standards to be implemented? This indeed calls for a deliberation, we should say.

4.1.1.2 Legal works

To examine a true and fair accounting information disclosure will need proper disclosing requirements and an assortment of legal works based on a uniform, thorough, and distinctive punishment regulations and legislation in treating to accounting information disclosure behavior. The former requirements give guidance on how to prepare a quality accounting information disclosure. The latter sets a binding power to accountants and auditors through overlooking and sanctioning the outlaw behavior occurring in accounting information disclosure in order to secure the information to be disclosed in a good quality.

From the preceding comparison between the U.S. and China the legal environment in these two countries differs. The existing laws and regulations are deficient in binding power and coherence in China. Different government departments and administration classification enact disparate versions of legal works pertinent to the same subject. The treatments of penalty, however, are not the same. It creates a complicated situation for the person who exercises these rules in sanctioning the law-breaker. There seem to be rules or laws in China everywhere, but in the case of fraudulent reports prepared by accountants or auditors, there are no rules applicable up to now, even though, this has become a subject under the discussion of the recent 12th National People's Congress, the highest legislature in China.

Accounting information disclosure, in our understanding, mainly refers to financial reporting. As acknowledged by the FASB, "financial statements are a central feature of financial reporting." (FASB, 1993, p.7). In a sound

legal system, if an accountant makes a fraudulent financial statement, he or she will be prosecuted by the injured investors who rely on this statement to make an investment decision. Severe and pertinent legal systems deter wrongdoings and ensure the implementation of the accounting system. Conversely, the same accountant just roams at large in a less rigorous legal environment. This leads us to believe that an accounting system requires a set of legal systems to sustain the plain sailing of the accounting system. Only to have an ideal-modeled accounting system without a commensurate legal environment is far from enough.

Still, based on our foregoing presumption, IAS-based Chinese accounting resembles the SFASs. We deem it as a perfect set of accounting system. When such a system encounters with an imperfect legal environment, we are afraid that the accounting system will not function because the legal environment is not capable of safeguarding the implementation of IAS-based Chinese accounting.

4.1.1.3 Ownership

The majority ownership of shares in China represents the State and is the biggest investor in most of the listed enterprises and it along with various tiers of authority agents are the main users of accounting information. This is evinced by the requirements for a company to be listed on the Chinese securities market, whose securities must be approved by the CSRC directed by the State Council. Meanwhile, all listed companies are mandated to submit their reports to the CSRC. According to these reports, the CSRC makes a decision whether a company is entitled to remain a listing in the securities market. Hence, many companies are driven by the purpose to meet the taste of the State and agents and make some false and misleading information disclosures in order to be listed or remain listing.

On the other hand, the concerns of the State, as the biggest shareholder, are not restricted to running for profits. It, from this point, diverges to the purpose of a stock market oriented accounting. We admit that one of the

goals for the State as a shareholder in the market economies might coincide with the purpose for profits at one time. Despite profits, as a public authority, the State might seek for all kinds of goals for the country and these goals vary from time to time. But one strategy that will by no means change, is to put the whole country's interest at the highest priority in order to secure the safety of the country and sustains the social stability politically and economically (Huang, 1999). The goal for the State acting as a shareholder is the same as that of the State acting as a public authority, otherwise, to pursue profits must be sacrificed for the strategy to ensure the safe of the country. "Where there is state ownership, the influence of centralized control on the nature of accounting systems will tend to override the serving of macroeconomic objectives." (Radebaugh and Gray, 1997, p.48).

From a financial reporting standpoint, different shareholders stand for different accounting information users. The FASB defines its accounting information users are "present and potential investors and creditors and other users." (FASB). The investor group mainly consists of equity security holders and debt security holders. A society as a specific user is out of the question by the FASB. "If society is designated a user, this leads to 'social accounting'. The kind of information desired by society goes beyond that provided to investors and creditors. The concept of 'social profit' captures the essence of what social accounting is all about. The basic difference between social profit and the more familiar profit of a business enterprise is that the former includes social benefits and costs," which is more difficult to measure (Kam, 1986, p.51). So the FASB "decided that the profession should not, at least for now, be officially responsible for reporting on the societal activities of the company." (Kam, 1986, p.51). Based on this premise, the service range of the SFASs of the FASB are restricted only within the group of investors, creditors and other users.

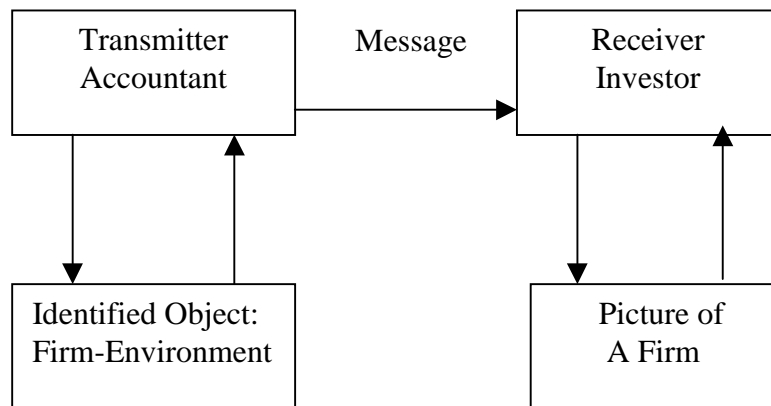
The contradiction stems from the standards of the FASB and the real situation in China. In other words, IAS-based accounting serves the users

just as those of the SFASs, who are investors and creditors. This conflicts with the actual users in China, who are the State as a whole. Due to the fact that the purposes for these two groups of users differ, most of the time, the requirements for accounting information are different. Summarized, one could say that the environment in China for adopting the IAS-based accounting system is thus immature.

4.1.1.4 Accounting and auditing professions

“Accounting is the process of identifying, measuring, and communicating economic information to permit informed judgements and decisions by users of the information.” (Most, 1977, p.97). Accordingly, it is a duty for accountants to transmit the information in the form of a financial statement that they observe of a company, to the users. Their capability, measurement, and knowledge are crucial to both the company and the investor-users. On one hand, if they fail to perceive the situation of the company, the information they give out will be misleading; on the other hand, if they incorrectly measure the company based on their knowledge and interpretation, the decision-maker will view a wrong picture of the company, and the information transmitted by different accountants at disparate level will be of variation. As a consequence, the qualification of the accounting professionals governs the quality of the information disclosure. The process of accounting information transmission can be portrayed in the following figure:

Figure 4.1.1.4 Process of accounting information transmission



Source: Kenneth S. Most, *Accounting Theory*, 1977, Grid Inc. p.97.

However, as we stated earlier in the paper, the qualification of the accounting professions in China is relatively low in general. Because of the transformation of the social structure, the accounting ideology has to adapt to the development of the changing environment. We may say that Chinese accounting professions are just at the outset. The corresponding accounting education and research are experiencing earthshaking changes, but the construction in the accounting infrastructure can not be finished overnight. The number of CPAs compared with the total population in China is really few. This situation agrees with the fact that the developing countries have a small number of accountants per capita compared with the high-income countries. Where there is a more developed accounting profession there is likely to be more developed, judgmentally based public accounting systems rather than more centralized and uniform systems (Radebaugh and Gray, 1997, p.41-48). Good accounting standards and systems are of little value if there are no good accountants to implement them. At present, there is a great shortage of accountants in China. Since the number of accountants is fewer, it is not right to mention the quality of accountants at all.

In spite of the paucity of accountants, there are a few more reasons for the problems than those arising from accounting information disclosure in China. We think the influence of management and the breach of independence of certified accountants are most important.

4.1.1.5 The influence of management of a company

Accountants, in China, are also the transmitters of accounting information of a company. They are employed by the management of the company and, thereby, give obedience to the volition of the management. Accordingly, the manner and intention of the management of a company are decisive to a qualified accounting information disclosure. As stated before, accounting information disclosure tends to compete with inefficient enterprises out of securities markets and remain efficient ones. By doing so, the market can realize an optimal allocation of resources, including labor, into a range of a society. This point is one of the environmental contexts of objectives of the FASB. Just because the accounting information helps this competition system in the markets, some Chinese companies, whose businesses run successfully by managers, as successful agents for the State, publish their accounting information on time. Some, on the contrary, publish late. As a result, some managers with a weak legal sense tend to exploit the accounting information to serve their own purpose, especially, when their companies have a bad operation and fail to represent the State as successful agents. They are driven by their own interests to either cheat the leaders of correlative departments in order to be listed, or cheat stockholders in order to raise money, or mold self-image, such as skillful management, profit corporation and so on, in order to be promoted or get bonus. These managers suborn accountants to prepare false and misleading accounting information, sometimes, omitting significant events at the expense of the infringement of the accounting requirements, laws, and regulations in accounting information disclosure.

4.1.1.6 Independence of accountants and auditors

Another reason, which attributes to the current situation of China's accounting information disclosure is that of the breach of the independence of accountants. Due to incomplete separation of ownership from management right, the binding system and the stimulation system brought by the separation of these two rights have, in fact, been lost. The State, with a majority share ownership of a company, delegates its power to various agents to practice its authority. It leads to an ambiguity as to, who is the *de facto* investor in the company. As the real owner of the company, the State is actually absent in the organization structure in the company. In addition, middle and small shareholders neglect the use of their voting rights due to a lack of force and effectiveness. Hence, the stockholders' meeting fails to exercise its power and rein over the directors of the company. Furthermore, the directors hold a very small number of the company's shares, and the compensation for them as owners of the company is very little as well. Consequently, the stockholder's meeting as a binding system, together with the compensation and bonus as a stimulation system, have nothing to do with these directors. There is no motivation for the directors to stand up to the interests of stockholders. The interests of the directors are closer to or sometimes equal to the ones of the management personnel, who act as agents of the company. The board of directors and the senior management personnel seem to be from one family. The selection of auditors and accounting firms, is determined by the president and senior management personnel of the company. This selection resembles a commitment more or less, that is, the auditor is assigned by the company to finish a job for the company's management personnel. The intention of the president and manager of the company affects the independence of the auditor. Besides, the accounting firms are set up within the Administration, provinces, cities and self-governing areas rather than by individuals or partners. They are more or less controlled by the local government. These accounting firms belong to non-business units and often have a close relationship with other units under the control of the State. From this standpoint, auditors have lost the status of independence. As a result, it normally involves no

indemnification responsibilities for the mistakes the auditor makes when examining certain companies. If the auditor delivers an auditing report with an untrue opinion and deserves a penalty, the correlated unit with the auditor's accounting firm will intervene and dissociate the auditor's duty.

From the external angle of degree, the number of the accounting professionals is far from satisfactory. From the internal angle of degree, the making and morality of accounting professionals still need a further improvement. We do not exclude the shortcoming of accounting regulation itself, because the requirements for accountants such as independence are not mentioned by the regulatory body in China.

Thus, one could say that "advanced" current Chinese accounting is in a dilemma with the laggard accounting professions. Indeed, it casts a shadow over the credibility to practice and exercise the IAS-based accounting by these low level standard and scarce accounting professions.

4.1.2 Is it appropriate for China to adopt only a stock market oriented accounting system?

The question before Chinese government can face an accounting reform is in what aspects China can follow internationally accepted standards, and in what aspects China must develop its own, that is based on its special conditions and characteristics derived from the social, economy, political, legal, culture aspects, which are indeed different across nations.

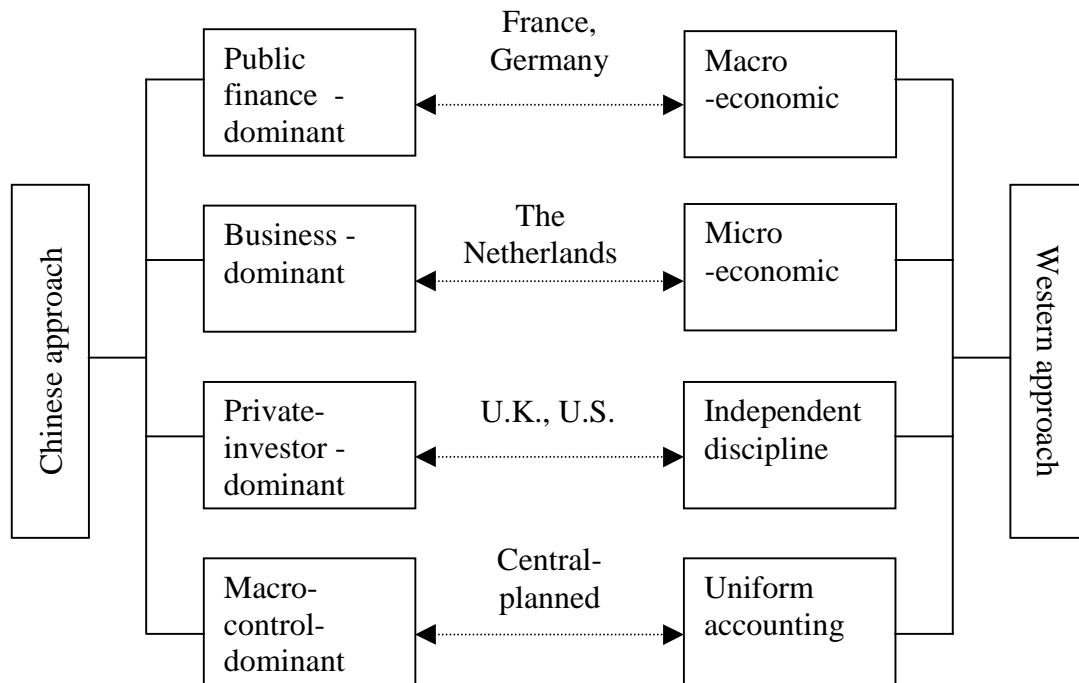
In order to develop our discussion, first of all, we will overview the different patterns of accounting systems worldwide, and identify the category that China may close to. Since the classification of accounting and reporting systems "should help policymakers assess the prospects and problems of international harmonization. Policymakers at national level will thus be in a better position to predict likely problems and identify solutions that may be feasible given knowledge of the experience of countries with similar development patterns. Developing countries looking

to choose an appropriate accounting system will also be better informed about the relevance for them of the systems used by other countries.” (Radebaugh, Gray, 1997, p.66-67).

4.1.2.1 Models of world accounting and reporting systems

As is well known the objectives of financial accounting and reporting play a guiding role for the evaluation and development of accounting standards. It is obvious that different models of accounting systems are adopted in different countries because of different economic backgrounds and accounting goals. According to Mueller (Radebaugh and Gray, 1997, p.67-68), four distinct patterns or approaches to accounting systems are classified, they are: *macroeconomic pattern*, *microeconomic pattern*, *independent discipline pattern*, and *uniform accounting pattern*. These patterns are closely linked to the relevant environmental factors of a nation, such as economic development, business complexity, political and social climates, and legal systems. A similar approach is also held by Chinese professions. Correspondingly, according to Yan and Xu (1995, p.153-155), four models can also be identified, they are *public finance-dominant model*, *business-dominant model*, *private-investor-dominant model*, and *macro-control-dominant model*. Regarding the classification of world accounting and reporting systems, Chinese and the Western scholars have reached a consistency in general, even with some little divergence when allocating countries to categories. However, this issue has always been a debate, and is relatively insignificant here. These four patterns of world accounting systems can be portrayed as follows:

Figure 4.1.2.1 The Chinese and the Western approach of international classification of accounting systems



Source: based on the information provided by Yan and Xu, 1995, “Issues on developing, promulgating and implementing of China’s applying accounting standards”, *Completing and Developing* (in Chinese), p.153-155; and Radebaugh and Gray, 1997, *International Accounting and Multinational Enterprises*, p.67-68.

In the *public finance-dominant model*, also identified as *macroeconomic pattern* in the West, business accounting correlates closely with national economic policies. It emphasizes that accounting information be made to better serve the nation’s revenue, and to ensure the government fiscal revenues. The goals of the corporation usually follow rather than lead national economic policies. It does not allow a gross divorcement of the tax revenue from the financial statement. It is traditionally mainly used in Germany, France, etc. In these countries, it is the government or the

legislature, which formulates the accounting standards, and non-governmental bodies only have a small role to play.

In the *business-dominant model*, also identified as the *microeconomic pattern* in the West, accounting is viewed as a branch of business economics. Recognition, measurement and disclosure are required as these will be of help to the existence and development of business and industries. This means that a fundamental concept is concerned with the maintenance in real terms of the monetary capital invested in the corporation. The rights of the companies are emphasized, and accounting standards leave much option room to the firms to help protect their interests and serve their management. Some European countries, such as the Netherlands, etc. adopt this model.

In the *private-investor-dominant model*, also identified as the *independent discipline pattern* in the West, accounting is viewed as a service function and is derived from business practice. The objective of the accounting standards is to safeguard the interests of investors, therefore, the "true and fair" view is very much emphasized in financial reporting and disclosing. This model can be found in Anglo-Saxon countries, such as, the U.K. and the U.S. People have reached a consensus that investors and creditors are the major users of external accounting information and that accounting information should be useful for their economy decision making. The expected cash flow is the information that investors and creditors are concerned with most.

The users of the fourth model, the *macro-control-dominant model*, also identified as the *uniform accounting pattern* in the West, include the central-planned economy countries, such as, the former Soviet Union, China (in old times), and other socialist countries most of the time. Under this pattern, accounting is viewed as an efficient means of administration and control. These countries decreed the accounting standards in the form of rules, regulations, and codes, and put much stress on accounting

information serving the macro-control and direct-control of the economy. Uniformity, mandatory and generally little freedom on method options are the characteristics of this model. Accounting's function of serving the investor is weakened and the role of accounting information in directing capital flow is largely restrained.

However, since 1993, China has adopted a completely new accounting system that conforms to the IAS, which as mentioned is a stock market oriented accounting. The following question will then be raised: if this stock market oriented accounting can be the only basis for setting up China's accounting system?

4.1.2.2 Is the stock market oriented accounting the only basis for setting China's accounting system?

As mentioned earlier, since the start of the IASC foundation, the IASC has been dominated by followers of the Anglo-Saxon (i.e. shareholders main users, equity finance supreme) rather than the European (i.e. banks main users, loan capital supreme) accounting system. The IAS is widely seen as preferable to US standards. Although based on principles of the U.K./U.S., they are a more practicable alternative for less developed countries than the implicit adoption directly of actual UK/US standards (Jones, 1998). So China has adopted an IAS-based accounting standards started by the 1992 ASBE and promulgated by the MOF.

The IAS is also preferable to many countries' stock exchanges. As mentioned, this Anglo-Saxon value based accounting mainly serves for stock markets, and those countries with a private investment-dominant model (or independent discipline pattern) of the accounting system, where the interests of creditors and investors are greatly emphasized. The UK and U.S. are as comprehensive examples here. Under this model, accounting mainly serves for investors, and is derived from business practice. "It is characterized by much fewer signs of government intervention in the job and business enjoys favorable conditions for free development" (Yan,

1992, p. 69). Non-governmental institutions have always had a big say in setting of accounting standards, and governments are relying on the organizations accredited by professional accountants for formulation and improvement of accounting standards.

But it is the opposite case in China, where government is both an investor and administrator of an enterprise. The state has the greatest power and control, whereas the accounting professional organization (CAS) and securities administrative authority (CRSC) are weak and stand in a less influential position. Therefore, in studying the question of accounting standards of China, one needs to take consideration of the China's special situation.

As stated in China's newly promulgated ASBE, "the accounting information must be desired to meet the requirements of national economy control, the need of all the concerned external users to understand an enterprise's financial position and operating results, and the needs of management of enterprises to strengthen their financial management and administration." (the MOF, 1999, p.60). Therefore, one can obviously see that the objective of the Chinese accounting is identified at three different levels, which are the State, external users, and enterprises.

China has a planned commodity economy. State planning and market mechanism is the two indispensable means in regulating the economy. The accounting standards to be established in China should serve the dual needs of facilitating state planning and upgrading the levels of managerial skill and decision making of enterprises (Yan, 1992). Accounting information has to serve not only the investor, but also planning and control.

Further, state-owned enterprises constitute the bulk and the backbone of the total, and the state is the largest investor. Although, one of the most important steps taken in China's economy reform is to separate ownership and administration of enterprises, and to corporatize the state-owned

enterprises. This means that the enterprises have more operating autonomy, and can raise funds in the capital market. The state is not the only owner of the enterprises any more. Many other public investors also can execute their control by means of the shares held. In fact, the state ownership is still dominated in most economy aspects. That is, in relation to state-owned enterprises, the government in China has a double status, being their investor and their administrator simultaneously. Therefore, accounting in serving the investor mainly serves the State or governments at all levels. On the subject of macro-control, the government is obliged to get such information as input and output of enterprises, operating effectiveness, the extent of implementation of the state directive projects and programmes, scale and trend of investments, etc.

Thus, there really is a special situation confronting to China. Consequently, it determines that neither of above four models mentioned is rational. China needs to have a unique accounting system of its own, which is different from that of any other nation. This system is better a connection between investors and managing personnel based on the multi-objective structure of the accounting standards. This accounting system, in our opinions, more or less tends to the first one, i.e. the public finance-dominant model (or macroeconomic pattern), where the state power requires greater attention, and business accounting correlates closely with national economic policies.

Even though China has been fast moving its steps in corporatizing state-owned enterprises, and separated its ownership from corporate management, through which the autonomy of enterprises is strengthened and interests of companies is protected. It is undeniable that the Chinese government has great impacts and absolute control, executed almost everywhere in the society. The state fiscal revenue is always served as the first requirement. These influences have been reflected in the China's standard-setting process and the structure of enterprises, as well as the listed companies in the stock market. Thus, in our opinion, in setting the accounting standards, it is not enough to only resemble the IAS. The

experience of some other countries, such as continental European countries, France and Germany, and Japan as well, which are identified as typical representatives of macro-economy pattern of accounting system, and as Jones (1998) says “have favored very regulated, tax-driven, creditor-based accounting practices”, should also be taken into the consideration, or maybe needs more concern.

Similarly, as noted, China has also resembled the U.S. more when formulating regulations for its securities market. But, determined by its ownership structure of enterprises, China’s stock market, not like the U.S. stock market, is of relatively minor importance as sources of finance and the relative lack of influence of shareholders right now. This is similar to France, where “the government plays a major role in the supply of finance to corporations” (Radebaugh and Gray, 1997, p.55). Again, it is argued that the U.S. or Anglo-Saxon accounting and information disclosure system should not be the only one drawn as reference to establish China’s accounting and reporting.

4.1.3 Stock market is not the only factor affecting accounting standards-setting

It is indicated by much finance and accounting researches that the stock market is an efficient processor of accounting information, but a contention is also well supported by numerous accounting theorists that the focus of accounting is not solely on stock market agents. The scope of a standards-setting body is broad. It should not necessarily be constrained by implications of the efficient markets hypothesis (Ketz and Wyatt, 1987).

Through our description and discussion of the whole paper, it can be seen that China’s standard setting has, to a large extent, used the experiences of other countries, especially of the IAS, which is an Anglo-Saxon based principle. So, China has used the experiences of the U.S. stock market when formulating its information disclosure requirements and other regulations. It is regarded that the U.S. stock market is “a well-developed

security market” with a long history, and “has a great degree of public financial disclosure than those with relatively less-developed markets (Radebaugh and Gray, 1997, p.55). It has also been noted that the development of China’s stock market has had a great impact on its standards-setting, and it has been called to our awareness that the MOF seems have placed too much emphasis on the reaction of the stock market, and omitted the needs of other interested parties.

But, as Ketz and Wyatt argued in their study (1987, p.720): “the FASB in a world with partially efficient markets”. “Stock markets are important, but they are not the alpha and omega of accounting”, because, “first, variety of institutions are affected by accounting rules in addition to the stock markets. Such as, taxing authorities, employees, customers, lawyers, regulatory or registration authorities trade associations; second, the efficient markets hypothesis does not seem to be descriptive of the real world with costly information. Third, markets might be efficient informational but not in an allocational sense”. Therefore, they suggest, “the FASB should also examine the effects, real or alleged, on these other institutions, it also needs to formulate policy given the fact that partially efficient markets characterizes the real world”. We think, this is also applicable in our Chinese case.

4.2 Conclusion

There is no doubt that, through a decade of accounting reform transforming from a rigid uniformed and central-planned economy-based accounting system to an IAS-based system which is stock market oriented, China has reached an obvious improvement in the quality of indigenous accounting and reporting and so has it reached on the information disclosure in China’s securities market through harmonization with the international conventions. These are evidenced by comparisons throughout the whole paper. The comparisons shed lights on the accounting system of China, the IASC, the FASB, and stock markets of China and the U.S. Thus, we could say that China’s accounting reform and the development of China’s securities

market is a process characterized by integrating international experiences with its own national features.

However, through the comparisons and discussions, some advantages and disadvantages in the Chinese current accounting system involving aspects of regulation, valuation rules, and information disclosure have been revealed. Since, accounting is “not immutable – it is affected by the economic, legal, political, and social environment in which it takes place” (FASB, 1993, p.1). Also it is notable that accounting standard-setting is in a changing process, it is not something constantly fixed. China’s accounting standard-setting body, the MOF, needs to adapt themselves to the changing environment, i.e. to serve the demands of users of accounting information.

Problems are also found in the stock market environment. In the paper, we assessed the Chinese current IAS-based accounting system mainly within its stock market environment. This is solved by comparing it with the U.S., which is a well-developed stock market and enjoys stock market oriented accounting. The mismatches found in China’s stock market have revealed its inappropriateness to implement the new accounting system. Such as, habitual interference of the government in enterprise management resulting in failures in most Chinese SOE’s restructuring to separate ownership from management control; unsounded legal works in regulation setting caused untrue and unfair information disclosure in practice. Also, the ability of the Chinese new accounting system to implement the stock market oriented accounting is suspect. This is mirrored by shortage of qualified accountants and audits and lacking of independence in accounting and auditing. The former is reflected in both external and internal aspects. That is the number of the accounting professionals is far from satisfactory, and the making and morality of accounting professionals still need a further improvement; the latter is represented by the influence of the company’s management and the state-own nature. It is therefore argued that if China’s current accounting environment, continuously characterized by the lack of the proper

environment, that can ensure compliance with the standards, the information provided under the new accounting system will be unreliable, and therefore adopting the stock market oriented accounting would be inappropriate in the specific context of China.

Thus, we think that China's accounting standards may mirror the IAS in many aspects, but satisfactory application of those standards is still a long way off. China needs to devote itself further into this process in the future. The country will have to continue its move toward implementing a sophisticated, transparent accounting and reporting system.

4.3 Future work

In this paper, we chose only the securities market perspective to assess and test China's accounting environment. But, as mentioned, there is still a variety of economic, social and political factors, which may affect a country's accounting and information disclosure. Therefore, future work is expected to give information from other perspectives.

Also, in the paper, we have just taken few countries or organizations as comparison counterparts, such as, the U.S. and the IASC. But, as discussed, from the international classification of accounting system, China may incline to some other countries, such as France and German, to some extent. In these countries, accounting correlates closely with national economic policies. Thus, a further and wider comparison concerning China's accounting and stock market is expected.

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APPENDIX

Appendix 1. The requirements of the information disclosure in China

The content and format of an Annual Report

Item 1 Business

- Chinese and English name and its abbreviate of a company
- Legal person of the company
- Secretary to the board of directors and the name, address, telephone numbers, fax numbers of his authorized representative of the company
- Registration address, office address, emails address and zip code of the company
- Place for storing annual report
- Bourse for trading stock, the abbreviated name and code of stock

Item 2 Summary of accounting figures and business data

1. *List current year's*

- Gross profit
- Net profit
- Income (loss) from continuing operations
- Income (loss) from non-continuing operations
- Earning of investments
- Subsidy income
- Net cash flow from operating activities
- Cash and cash equivalents

2. *Last 3 years selected financial data in tabular forms*

Item 3 Changes of share capital and stockholders

1. *Changes of share capital*

1) *The change of shares in tabular form (see attached form)*

2) *Description of the stock issuance and trading of the company*

- Last three years' stock issuance

- Changes in shares and share structure caused by stock distribution
 - Employees' shares including share prices, issuing date, issuing amounts, and so on
2. *An introduction of stockholders*
- Approximate number of holders, among them, the number of shares held by employees
 - Any person as a beneficial owner of more than 5 percent of the registrant's voting securities
 - If the number of holders owning more than 5 percent (inclusive 5 percent) of shares is less than 10, list the name of the holders and relationship with each other if they have
 - Number of the state-owned shares and foreign holders;
 - Number of shares owned by persons who hold more than 10 percent shares of the company, and name of legal person and business scope of these persons
 - Change of registrant in the period of annual report should be published in the CSRC designated newspaper
 - Name, share owned, and share changes of directors, executive officers, and supervisory personnel together with an explanation for share number changes

Item 4 A brief introduction of stockholders' meeting

- *Introduce stockholders' meeting*
- *The arrival of the number of stockholders*
- *The election of directors and the term of directors*
- *A brief description of matter voted upon at the meeting*
- *Promoters and control persons*
- *Identification of directors*
- *Business experience*
- *All compensation covered*

Item 5 A report from the board of directors

1. *The working report of the board of directors*

- Describe the meeting of the board of directors within the period of annual report
- The execution of the board of directors to the decisions of stockholders' meeting
- The employment of managers and secretary to the board of directors of the company

- Explain the items which are shown in auditor's report are against the opinion of the auditors
 - Explain for the differences between forecast and actual profits within the period of annual report if the forecast is 10% higher than the actual or the forecast is 20% lower than the actual profit
2. *An introduction of executive management officers*
 - Identification of executive officers
 - Business experience
 - All compensation covered (all payments in any form of compensation to executive officers)
 - Persons covered (current executive officers)
 - Information for full fiscal year
 3. *A preliminary plan for distribution of profit or for an increase in share capital transferred from reserved funds.*

Item 6 A report form the supervisory committee

Item 7 A summary of business report

1. *An introduction of ranking in business of line (for example, the rank by total sales)*
2. *Business operations within the period of annual report*
 - 1) *Address the range and business position from continuing operations of the company, particularly, the business operations and its subsidiaries, which account for more than 10 percent of the income from continuing operations. It is applicable to the products, which account for more than 10 percent of income from continuing operations as well.*
 - 2) *Segment information will be required if the registrant has overseas operations*
 - 3) *Financial position and business operations of the registrant*
 - Net sales or operating revenues
 - Income (loss) from continuing operations
 - Income (loss) from continuing operations per common share
 - Total assets
 - Long-term liabilities
 - Stockholder's equity

4) *Description of the business operations of major wholly-owned subsidiaries of the registrant*

5) *The number of employees, organization structure (for example, the number of workers, sales staff, technical staff, accounting staff, and administrative staff, etc.), the education of employees, and the number of retirees.*

6) *Problems and difficulties in business operations and resolutions*

3. *Capital resources*

- *Describe the difference of the registrant's material commitments for capital expenditures and the actual capital expenditures (explain if there is no such capital expenditures, the place where the capital is in use)*

- *Explain if the material commitments remain, the investment situation of capital and the planned return and if the return has taken place already, compared with what is in the commitment. Explain the difference between the actual and commitment.*

- *Explain if the material commitments have changed*

4. *Results of operations*

Address the environment of production and business operations and policies and regulations changes that have already influenced, and that currently influencing, and that will influence the financial status and results of operations of the registrants.

5. *The development plan for new fiscal year including the forecast of the process for new and old projects*

6. *Other information that needs to be disclosed in relation to business*

Item 8 Current report (significant events)

1. *Legal proceedings*

1) describe legal proceedings involving after publishing Interim Report of a company;

2) if any legal proceeding has been included in Interim Report, but it has no result up to that time, this legal proceeding should be included in Annual Report and state the influence it caused;

- 3) otherwise, state no legal proceedings in Annual Report.
2. *Acquisition or disposition of assets*
3. *Related parties transactions*
4. *Receivership*
5. *Changes in registrants' certifying accountant*
6. *Other material contracts*
7. *Changes in the name and abbreviate name of stocks of the registrant*
8. *Other events*

Item 9 Financial reports

1. Auditor's report

The auditor's report must be prepared by the qualified accounting firm related to securities business and its two certified public accountants.

2. Financial statements

The preparation of financial statements should obey the policies, laws, and regulations of the State.

1) Audited consolidated financial statements

- Consolidated balance sheet covers two recent years in tabular forms
- Consolidated statements of income covers two recent years
- Cash flow statement
- Changes in other stockholders' equity
- Value-added tax statement
- Assets statement

2) Footnotes to financial statements

- Business
- Principles of consolidation or combination
- Tax items

Categories of taxes and tax rate

- Subsidiaries and joint-venture companies
- Explanation for main items to financial statements
- Other financial statement items

Describe irregular financial statement items, or the name of item that can not reflect the property of the item itself, and uncommon amount of financial statement items.

- Segment information
- Related parties transactions
- Contingent items
- Commitments
- Other significant events

3) *Audited financial statements of parent company*

4) *Audited financial statements of unconsolidated daughter company which deals with special business*

Item 10 Other related information

Including registration date and addresses, registration number, and tax registration number, etc.

Appendix 2. The requirements of the information disclosure in the U.S.

The content and format of Annual Report

Part I

Item 1 Business

- General development of business
- Financial information about segments
- Narrative description of business
- Financial information about geographic area
- Available information
- Reports to security holders
- Enforceability of civil liabilities against foreign persons

Item 2 Properties

State briefly the registrant's principal plants, mines, and other materially important physical properties.

Item 3 Legal proceedings

Item 4 Submission to a vote of security holders

- The date of meeting
- The election of directors and the term of directors
- A brief description of matter voted upon at the meeting

Part II

Item 5 Market for registrants' common equity and related stockholder matters

- Market information
- Holders
- Dividends

Item 6 Selected financial data

Item 7 Management's discussion and analysis of financial condition and results of operation

1) Segment information

Full fiscal year (a discussion covers 3 current years covered by financial statements)(Discuss registrant's financial condition, changes in financial condition and results of operations)

- I. Liquidity
- II. Identify any known trends or any known demands, commitments, events or uncertainties that will result in the registrant's liquidity increasing or decreasing in any material way.
- III. Capital resources
- IV. Describe the registrant's material commitments for capital expenditures as of the end of the latest fiscal period, and indicate the general purpose of such commitments and the anticipated source of funds needed to fulfill such commitments.
- V. Describe any known material trends, favorable or unfavorable, in the registrant's capital resources. Indicate any expected material changes in the mix and relative cost of such resources. The discussion shall consider changes between equity, debt and any off-balance sheet financing arrangements.
- VI. Results of operations
 - Infrequent or unusual events or transactions or significant economic changes affect reported income
 - Known trends or uncertainties will affect revenues, net assets, and income from continuing operations
 - Disclose a material increase in net sales or revenues and discuss about factors attributed to this increase
 - 3 recent years inflation and changing prices on registrant's net sales and revenues and on income from continuing operations

2) Interim periods

Material changes in financial condition

Material changes in results of operations

Item 7A Quantitative and qualitative disclosures about market risk

Item 8 Financial statements and supplementary data

Item 9 Changes in and disagreements with accountants on accounting and financial disclosure

Part III

Item 10 Directors and executive officers of the registrant

- Identification of directors
- Identification of executive officers
- Identification of certain significant employees
- Family relationship
- Business experience
- Involvement in certain legal proceedings
- Promoters and control persons

Item 11 Executive compensation

- Treatment of specific types of issuers
- All compensation covered
- Persons covered
- Information for full fiscal year
- Transactions with third parties
- Omission of table or column
- Location of specified information
- Liability for specified information

Item 12 Security ownership of certain beneficial owners and management

- Securities ownership of certain beneficial owners
- Securities ownership of management
- Changes in control

Item 13 Certain relationships and related transactions

- Transactions with management and others
- Certain business relationship
- Indebtedness of management
- Transactions with promoters

Part IV

Item 14 Exhibits, financial statement schedules, and reports on Form 8-K

Appendix 3. Comparison between Chinese accounting standards (ASBE, IED) and the International Accounting Standards (IAS)

THE IAS	CONTENT POINTS	THE ASBE CLOSING TO IAS	CONTENT POINTS (COMPARED WITH THE CORRESPONDING IAS)
IAS1. Presentation of Financial Statements	Balance sheet, Income statement, Cash flow statement, statement showing changes in equity.	IED6. Balance sheet, IED7. Income statement, IED10. Owner's equities, ASBE2. Cash flow statement.	Same as IAS1, but more condensed. The statement showing changes in equity is not required.
IAS2. Inventory	Valued at the lower of cost and net realizable value, using method of FIFO or weighted average, LIFO.	IED3. Inventory	Valued at the historical cost. Various methods are allowed, such as, at individual planned cost, at planned cost or quoted cost, at selling price, etc. The ending inventory is valued at the lower of cost and net realizable value.
IAS3	Replaced by IAS27 and IAS28.	-	-
IAS4. Depreciation accounting	On a systematic basis using a consistent method	-	-
IAS5	Replaced by IAS1.	-	-
IAS6	Replaced by	-	-

	IAS15.		
IAS7. Cash flow statements	CF from operating: direct or indirect method.	ASBE2. Cash flow statements	CF from operating: direct method only.
IAS8. Net profit or loss for the period, fundamental errors and changes in accounting policies	Disclosure of extraordinary items, change in accounting estimate, accounting errors and accounting policy, the changes may be included in adjustment of retained earnings, or the net P/L. Restating all prior periods presented.	ASBE8. Changes in accounting policies and accounting estimates, and corrections of accounting errors	Same as IAS8. But, when accounting polices are changed, the restatement of prior year's F/S is not required.
IAS9.	Replaced by IAS38.	-	-
IAS10. Events after the balance sheet date	Conditions for financial statements adjustment	ASBE3. Events occurring after the balance sheet date	Same as IAS10, but more condensed.
IAS11. Construction contracts	Using percentage-of-completion method when an reliable measurement and estimation is possible. Otherwise, using cost recovery method.	ASBE7. Construction contract	Almost same as IAS11, but, when costs will not be recovered, revenue should not be recognized, and costs are recognized as expenses immediately.
IAS12. Income taxes	Accrual basis	IED18. Income taxes accounting	Same as IAS12. Content about permanent distinction and timing distinction,

			their effects on taxation and accounting treatment is specifically prescribed.
IAS13	Replaced by IAS1.	-	-
IAS14. Segment reporting	10% materiality thresholds.	-	-
IAS15. Information reflecting the effects of changing prices	The following information on a general purchasing power or a current cost basis: depreciation adjustment, cost of sales adjustment, monetary items adjustment, and the overall effect of the above and any other adjustment.	-	-
IAS16. Property, plant and equipment	Measured at initial cost, then using depreciated (amortized) cost or up-to-date fair value. Revaluation is allowed.	IED8. Fixed assets	Valued at initial cost. Assets revaluation is also allowed. Various depreciation methods are allowed, such as: depreciation of straight line, working process, doubled balance degressive, sum of useful lives.
IAS17. Accounting for leases	Lessee: capitalizing a finance lease at the	IED27. Leases	Almost same as IAS17.

	<p>lower of the fair value and the present value.</p> <p>Lessor: allocating financial income using the net investment method.</p>		
IAS18. Revenue	<p>Classification: revenue from sale of goods, services, interest revenue, dividend revenue. Measured at fair value. Bad debt can be recognized. Accounting for barter transactions is also mentioned, they are measured at fair value.</p>	ASBE5. Revenue IED30. Non-currency transactions	<p>Classification: revenue from sale of goods, services, revenue arising from the use by others of enterprise assets includes interest and royalty. Bad debt recognition has not been mentioned. Non-currency transactions are measured at fair value.</p>
IAS19. Employee benefits	<p>Contribution: as an expense; benefit plans: on accrual basis.</p>	IED22. Employee benefits	<p>Benefits include social insurance for employees, reserved funds for housing, other benefits. Recognized and valued at actual costs incurred.</p>
IAS20. Accounting for government grants and disclosure of government assistance	<p>Grants should be recognized as income.</p>	IED23. Donations and government assistance	<p>Outgoing donations: as non-operating expenses. Incoming donations: as increased equity. Various accounting</p>

			treatments of grants are used dependently.
IAS21. The effects of changes in foreign exchange rates	<p>Foreign currency transactions: should be translated on the date of the transactions.</p> <p>Income statement items are translated at the average exchange rate.</p> <p>Investments in foreign entities: depending on different nature of investments:</p> <ul style="list-style-type: none"> - Balance sheets: monetary balances use closing rates, non-monetary balances use rate relating to the valuation basis, or closing rates B/S; - Income statements: average rates, or transaction rate; <p>Differences: taken to income or equity, depending on</p>	IED17. Foreign exchange	All foreign exchange transactions except investments in foreign currency, are recorded at rate of occurring date, or rate of current period, and adjusted at closing rate of balance sheet date. Differences are taken to the “profit & loss of exchange” account. The remaining requirements are kept same as IAS21.

	different situations.		
IAS22. Business combinations	Uniting of interests: use pooling of interests method, no goodwill is recognized; acquisitions: purchase method, fair value basis, positive goodwill is amortized normally ≤ 5 yrs. (or ≤ 20 yr.). Negative goodwill is recognized as income.	IED29. Enterprise combination	Pooling of interests method and acquisition method is classified. Amortization period for positive goodwill is 10 yr., for negative goodwill is 5 yr. Consolidated F/S is required for both type of combination.
IAS23. Borrowing costs	Borrowing costs are recognized as expenses or to be capitalized.	IED5. Capitalization of borrowing costs	The costs incurred before completion of an asset construction is included in cost of this asset; otherwise, recognized in current profit & loss immediately.
IAS24. Related party disclosures	Disclosure of nature of relationships, nature and amount of transactions is required.	ASBE1. Disclosure of related party relationships and transactions	Same as IAS24. Additionally, state-controlled enterprises should not be regarded as related parties normally unless it fits the definition of related parties.
IAS25. Accounting for	Current investments:	ASBE6. Investments	Same as IAS25. But, Long-term

investments	valued at market or at the lower of cost and market; long-term investments: valued at cost, revalued amount, or the lower of cost or market for marketable equity securities.		investments consist of long-term debt investments or long-term equity investments. The former is further divided into investments in bonds or other debt investments.
IAS26. Accounting and reporting by retirement benefit plans	Standards for reporting by defined benefit and contribution plans.	Some are dealt in IED22. "Employee benefits"	See prior description
IAS27. Consolidated financial statements and accounting for investments in subsidiaries	Subsidiaries may be shown at cost, at revalued amounts, or using the equity method.	IED19. Consolidated financial statements	Same as IAS27.
IAS28. Accounting for investments in associates	Equity method or the cost method when consolidated.	-	-
IAS29. Financial reporting in hyperinflationary economies	Cumulative inflation over 3 yr. $\geq 100\%$, F/S should be presented in a measuring unit at the balance sheet date.	-	-
IAS30. Disclosures in the financial statements of	Financial statements' items should be grouped by nature. Special	IED14. Basic business of banks	Same as those required in IAS 30 concerning banks.

banks and similar financial institutions	disclosures are required.		
IAS31. Financial reporting of interests in joint ventures	Separate requirements on jointly controlled operations, jointly controlled assets, jointly controlled entities.	-	-
IAS32. Financial instruments: disclosure and presentation	Presentation: FI should be classified into liabilities and equities. Disclosure: risks, fair values of FI, hedges.	-	-
IAS33. Earnings per share	Public companies only. disclose basic and diluted net income per ordinary share in I/S.	-	-
IAS34. Interim financial reporting	Presentation and measurement guidance, content, and accounting recognition and measurement principles is set out.	-	-
IAS35. Discontinuing operations	Set out a basis for segregating information about an enterprise's major operation discontinued from information about	-	-

	its continuing operations.		
IAS36. Impairment of assets.	Requirements for identifying impaired assets, measuring recoverable amount, recognizing or reversing impairment loss and disclose it.	-	-
IAS37. Provisions, contingent liabilities and contingent assets	Requirements for provisions recognition and measurement. Recognition of contingent liabilities and contingent assets is prohibited. Disclosure is required.	IED24. Contingent events and commitments	Contingent loss should be recognized. Whereas, contingent profit is not recognized normally. Concerning disclosure is required.
IAS38. Intangible assets	It especially applies to expenditures on: advertising, training, start-up and R&D. Recognized at cost, and amortized normally <= 20 yr.	IED9. Intangible assets IED12. Research and development	Valued at acquisition cost. Amortization is required, but its period is not specifically prescribed.
IAS39. Financial instruments: recognition and measurement	All financial assets and financial liabilities are measured at fair value with some exceptions.	IED28. Futures	Rules concerning future transactions are prescribed according to the natures of companies.

			Regarding treatment of transaction profit or loss: normally, it is based on historical cost principle, i.e. floating profit or loss before maturity of futures is not recognized.
-	-	ASBE4. Debt restructuring	Definitions and types debt restructuring is prescribed. So is the accounting by creditors and accounting by debtors. The concerned disclosure is required.
-	-	IED1. Payables	Payable is valued by various ways depending on its attribution, such as: at the original cost, or at face value plus book value, or fair value.
-	-	IED2. Receivables.	Recorded when income is realized. Accounting for bad debt should use allowance method, or direct method.
-	-	IED15 Deferred assets	Amortization period is not more than 5 yr.
-	-	IED26.	Classification:

		Liquidation	bankruptcy, withdraw, dissolution. Based on net realizable value. Liquidation balance sheet and statement of changes in net assets, as well as statement of allocated liquidation assets are required.
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Notes:

ASBE: Accounting Standard for Business Enterprises;

IAS: International Accounting Standards;

IED: Inquiring Exposure Draft;

FIFO: first in first out;

LIFO: last in first out;

CF: Cash flow;

P/L: profit and loss;

F/S: financial statement; yr.: years;

FI: financial instruments;

B/S: balance sheet;

I/S: income statement;

R&D: research and development.

Source: based on the information provided in the IASC's Website: (<http://www.iasc.org.uk>), and Liu Feng, 1996, *A Study of Accounting Standards* (in Chinese), pp.276-281.