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A View on the Process of Accounting Standard Setting in The People's Republic of China

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Publication Details

This paper was originally published as Zhang, Y, Andrew, J and Collier, HW, A View on the Process of Accounting Standard Setting in The People's Republic of China, Applied Business Research Conference, Orlando, USA, 2-6 January, 2008.

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Abstract

This paper is a discussion of how the People's Republic of China is attempting to revise accounting standards. Historically, China's accounting standards were dominated by 'management' accounting and compliance and achievement of goals and objectives established by central planning authority. As China seeks Foreign Direct Investment in formerly State Owned Enterprises, competitive pressures demand a change of emphasis in financial reporting. Much of the Western world is adapting IFRS for financial reporting. IFRS seems to privilege western dialogue in the adoption and acceptance of standards if PRC wishes to access the world wide capital markets. Consistency and comparability of financial reporting is one of the objectives of the shift to IFRS in China. The authors attempt to explain how and why China moved from an economy dominated by the beliefs of Chairman Mao's socialist agenda to today's more market oriented economy.

Keywords

accounting, standards, political

Disciplines

Business | Social and Behavioral Sciences

Publication Details

This paper was originally published as Zhang, Y, Andrew, J and Collier, HW, A View on the Process of Accounting Standard Setting in The People's Republic of China, Applied Business Research Conference, Orlando, USA, 2-6 January, 2008.

**The Convergence of IFRS in China: A view on the
influence of political ideology on Chinese accounting
profession**

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¹ The authors wish to acknowledge the contributions and suggestions made by the Research Forum of the School of Accounting and Finance, University of Wollongong, and reviews and suggestions of Mr Ronald W Perrin, Sub Dean of the Faculty of Commerce, University of Wollongong.

Abstract

A historical perspective lens may be useful to help people understand the world of accounting and accounting research. Some believe that the role that accounting plays in current society could be better understood by reviewing its historical association with the institutionalization development within which it operates. Accounting as it is practiced in capitalist system has been predominately viewed as a technical and context-free activity. However, if a meta-level concern addressing broad structural and institutional environment from which accounting emanated is absent, there must be doubt that the conventional accounting can claim to be comprehensible and to contain true information. This paper tries to explain why and how China moved from a uniform accounting system to IFRS and what the role the political ideology played during the process. By examining the development of China's accounting regulatory change, the paper provides reasoning and evidence of how ideological factors affect accounting practice and theoretical construction.

Despite the debates over the merits and feasibilities of global accounting standards in many years, the spread of multinational operations and the flourish of global capital markets have summoned more and more nations to either adopt International Financial Report Standards (IFRS), or based their local standards on IFRS. China, as being the world's fourth-biggest economy, has turned ally since the Ministry of Finance (MOF) of China released the new Chinese Accounting Standards (CAS) in February 2006, which have become mandatory for all listed companies after 1 January 2007. The new CAS substantially changes the nation's old accounting system and covers nearly all topics under the current IFRS literature (PricewaterhouseCoopers 2006).

The convergence of IFRS in China has been a result of ongoing socio-economic reforms and developments cross-fertilized by internal and external factors. Although there has been an increase in the amount of research addressing the influence of those ideological factors such as differences in culture, economic and political systems on accounting regulatory change (Clapp 1967; Mueller 1968; Choi 1973), there is still a lack of strong reasoning and evidence of how an ideology facilitates the accounting profession and little research of this type has been addressed in the Chinese context.

Historically, China adopted a uniform accounting system to sustain and legitimize its political agenda which was fundamentally different with that have privileged in Capitalist societies. Today, however, China has kept abreast of the Western world by shifting its accounting standards to IFRS for a better access into the flourishing global capital market. The paper tries to explain how and why China moved towards a different direction and what the role the political ideology played during

the process. By examining the relevant ideological discourses in China since 1949, the establishment of People's Republic, to the most contemporary era, the paper demonstrates examples of how these ideological factors affect accounting practice and theoretical development. The main approach is focused on how dominant political ideologies shaped the history of the definition of accounting terms and how they created an environment which expels or supports particular accounting concepts. The debates over Conservatism in these eras were examined and referred to as examples of the arguments.

1. from 1949 to 1978

Since 1949, the establishment of People's Republic, until the opening-up and economic reform introduced in 1978, China was substantially overruled under Mao Tse-Tung's regime. The former Soviet accounting model provided important guidelines for the new Maoist regime (Hilmy 1999). As a typical phenomenon at the time, the battleground of accounting researches was not in the academic or practical consideration, but in politics. The political reality was Mao's philosophy that a powerful central leadership and nationally upheld principles are the prerequisite for building a powerful socialist country (Mao 1993). Under the premises, the dominant political ideology under Maoism was characterized by class struggle primacy, public ownership and central planning.

The class struggle primacy which was orientated from the Marxist notion of class struggle had generated distinct debates on accounting between China and the West. While those early 20th century Anglo-American accounting theorists proposed great interests in the relationships between accounting and economics (e.g. see Paton 1922;

Hatfield 1927; Canning 1929; Gilman 1939), early Chinese accounting practitioners were debating whether 'foreign' accounting methods should be adopted based on the consideration that whether accounting is class-based. In 1951, a famous academic Huang, Shou-ding (1951) published an article named "How to develop an accounting theoretical basis for the new China" in the first issue of journal "New Accounting", in which Huang claims that "...different socio-economic systems brings different accounting modes...Capitalism has its accounting theory suitable to the capitalist system...the new PRC adopts a socio-economic system distinct to the Capitalism which requires a different accounting theoretical basis..." Under the political climate at the time, such a claim was re-interpreted further into debates such as "different classes should have different accounting systems", "accounting belongs to class" and "accounting is class-based", etc. Some academics argue that capitalist accounting theory and practice suit and protect the capitalist economic system; some academics argue that accounting functions as a means of accelerating class exploitation (Xin and Huang 1951). Practitioners believed that socialist accounting should be based on Marxist political economy and began to ask questions. Among those questions were: (1) whose interest does accounting serve? and (2) who controls accounting?" (Ezzamel, Xiao et al. 2007, p. 677) The legitimized view was that the purpose of accounting information was to meet the needs of working class or proletariats rather than those users such as managers or investors (Grady 1965; Paton and Littleton 1970) that are familiar to the West.

The principle of conservatism was brought into the debates through a distinct political lens (Brunswik, 1952). Capitalists' interests were believed to be protected because "if a high profits is desirable, assets are valued high whereas if a reduced profit is desired, assets are valued

low” (Xin and Huang 1951, pp. 13-14). Conservatism also was claimed to mask the exploitation of surplus values and to speed up capital accumulation (Yan 1951). Similar viewpoints overwhelm other counter viewpoints because of the dominance of the political atmosphere.

Central planning was another reality of the Chinese economy under Mao². Government planned the demand and supply of resources and outputs. Enterprises had little autonomy. A uniform accounting system was adopted to report adherence to the central plans. There were serious political risks if accountants made unauthorized changes in the accounting system. The uniform accounting system was regarded as helpful in sustaining and legitimizing central planning.

A peaceful and flourishing economy had been used as a symbol of political aspirations. But concerns for production, economic efficiency or profitability were condemned (Hilmy 1999) due to the ‘capitalist nature’. Accounting, basically served to ensure that, regardless of cost, the plan’s goals were achieved (Hilmy 1999). The Maoist discourses which created the context of the debates over accounting banished the principle of conservatism because conservatism was believed to reduce government control over profits of the enterprise (Ezzamel, Xiao et al. 2007).

Under state-ownership, the State Owned Enterprises (SOEs) remit their profits to the State and the State allocates funds to the SOE on a needs basis. Fiscal revenues were obtained from profits collected from the

² Although since 1956 there has been a reform effort to decentralize the administrative system in China, it was interrupted by the “Great Leap Forward” movement. In his conversation with district coordinators, Mao demanded that the powers (over personnel, industrial, commercial, and financial issues) decentralized in the past few years be reverted back into the hands of the central- and the provincial-level governments.

SOE. Some believe that accounting in a capitalist system focuses on capital and dividends distribution, Socialist accounting was built to reflect public ownership and the distribution relationship between the enterprise and the State (Gu 1982). Since the State attempted to control everything from production quantities, product quality, distribution channels and the costs of SOE, conservatism was deemed unnecessary. Some regulators even believed that there was no accounting for individual SOE, but only for the one for the national economy (Ezzamel, Xiao et al. 2007, p. 681). The role of accounting had been marginalized because of extreme political sentiments. For example, in the “Great Leap Forward” movement from 1958 to 1961 the government assigned unreasonable expectations on production and required the national economy to grow exponentially. Mao wanted China to catch up with England in fifteen years (Mao 1993). As Mao refused to see bad news, lies and exaggerations prevailed (Wang 1992, p. 149) as people reported what they believed Chairman Mao wanted to hear. For instance, In September 1958, *People’s daily* reported that ‘the biggest rice sputnik’ yet had produced over 70 tons from less than 1/5th of an acre, which was hundreds of times the norm (cited from Xiao 1998). Conservatism was absolutely rejected during the movement when sky-high yields and outputs filled the press and enterprises’ report. (Yang 1998)

The central bureaucracy brought China to economic chaos and overwhelming red tape and bureaucracy. These unrealistic expectations and goals eventually forced people to rethink the country’s administrative system. There were proposals made to increase decentralized administrative power over production.

In 1963, a central government document on industrial development

indicated that “Industries and enterprises should be managed by economic means, not administrative means” (Ren 1998, p. 162). On August 17, 1964, the Party Central Committee and the State Council approved “the Report of Opinions on Experimenting with Industrial and Communication Trusts.” Twelve industry trusts were established with the aim of increasing economic effectiveness and efficiency by transferring the administrative power into the hands of individual business managers. However, such a movement was against Mao’s personal agenda which henceforth was interrupted by Mao’s next political campaign - Cultural Revolution. The fears of losing power to the Party’s administrative executive Liu Shaoqi prompted Mao to start a Cultural Revolution which lasted from 1966 to 1976. Many believe that this ‘Cultural revolution’ brought economic, political and social disaster to the whole nation. During the ten years time, millions of clerics were exiled to villages or labour camps for ‘thought rectify” (Jopson 2006). Chaos multiplied in schools and universities. Profits or costs were not taken into account in manufactures where products were produced only for the sake of political tasks. The development of accounting theory or practice had been systematically suspended.

2. from 1978 to 2007

The Cultural Revolution ended with Mao’s death in 1976. Deng, Xiao-ping, representing people’s willingness for better economic well-off seized the political power and became China’s leader. An overall economic reform and “opening-up” policy has introduced since the Third Plenary Session of the 11th Central Committee of the Communist Party of China (CPC) held in December 1978. The three ideological principles in Mao society was gradually changed during this period.

Firstly, class struggle primacy was replaced by economic development primacy. CPC (1981) claimed that the main contradiction in China was between an increasing material and cultural demand and a lagging social production³. In September 1978 when he visited northeast China, Deng pointed out that the foremost task of the Party was to shift the focus into the socialist economic construction. Deng held a famous Cat theory - no matter if the cat is a white cat or black cat, as long as it can catch a mouse, it's a good cat (Deng 1977). It sent a message to people who were still wide about judging a thing based on its socialist or capitalist orientation that any means, regardless political designation, could be used to develop socialist production. The class struggle orientation has become even vaguer in the "Three Represents" theory which was formulated by Jiang, Ze-min, the successor of Deng, in February 2000. " Three Represents' " claims that CPC must always represent the requirements of the development of China's advanced productive forces, the orientation of the development of China's advanced culture, and the fundamental interests of the overwhelming majority of the people in China. The "Three Represents" was aimed at expanding the party's popular support and broadening its base from representing only workers and peasants to include private entrepreneurs⁴.

Under the more relaxed political climate after the 1978 economic reform, a discourse framing accounting as a technical and neutral technology started to challenge the class-based view of accounting. Deng (1978) viewed science and technology as the most important productive forces

³ Social production is a direct translation from Chinese term which means economic development. Due to the political consideration, the CPC didn't directly adopt economic terms used in Capitalist system although they are in a very similar nature.

⁴ Under the theory, those private entrepreneurs that were regarded as the Party's revolution enemies are allowed to join the CPC as being present China's advanced productive forces. Leftists in the CPC hold that the theory changed the nature of the party towards capitalism and it's dangerous to the Party.

in socialist construction. Academic journals began to publish papers proclaiming that as a management science accounting theories and methods adopted in capitalist countries could also be used in socialist countries to serve the needs of production and control. In 1980, at the conference celebrating the establishment of Chinese Accounting Association, Professor Yang, Jihun and Professor Yan, Dawu present their paper “Comments on the current accounting research in China – a discussion about the scientific feature of accounting”. They (Yang and Yan 1980) proposed that “accounting is a means of management in nature”.

Some academics argued that the adoption of conservatism was inevitable and well suited to a commodity economy like that of China (Jia 1987). Academics also pointed out that conservatism was necessary in order to solve the problems in SOEs where managers exaggerate profits to meet targets set by the State. Such a view might be charged as a serious political offence before.

However, during the early stage of the economic reform, the debate about conservatism remained evident due to the enduring influences of previous political campaigns under Maoism. People were still afraid of speaking out their true thinking as they were not sure about the political climate. Some academics still claimed that conservatism was a means to protect capitalist interests and hide working class exploitation (Yu 1981; Zhang 1991). Despite the different voices, the broad political reality has remained largely unchanged since 1978. Seeking economic development has become the center task in the Party’s agenda. Hu Jin-tao, the president of China and the top in the Party’s hierarchy, stressed in his 2007 New Year Address that the government will strive to give impetus to the shift in economic restructuring and in the mode

of economic growth (Xinhua 2007). Hu (2007) said that "2007 is an important year in building a socialist harmonious society under the guidance of the scientific development concept". 'Scientific concept of development' - a catchphrase in China today which was promulgated by Hu in 2002 has been proposed to be enshrined in the Party constitution in the 17th CPC Congress in October 2007 (People's Daily 2007).

Second, after the 1978 economic reform, the reliance on a planned economy was replaced by a limited market economy. The concept of "commodity economy" was adopted to support the proposal that socialist products should be shifted to a supply and demand economy where production and exchange are regulated by a market rather than being centrally planned by the State.

The Planned Commodity Economic Theory proposed by the CPC (1978) in the economic reform implies that the laws of value and competition are important in any commodity economy system. This, in turn, offers an ideological motivation for accounting change. Relevant discourses began to argue that the old accounting systems which were established under the planned economy model were not suitable for the development of a commodity economy and were incapable of reporting on economic reform.

In 1992, Deng visited some coastal cities in southern China and released a series of speeches. Those speeches reassured people's confidence on government's opening-up and economic reform policy. Although Deng's objective was to create a market economy, his theory about socialist market economy convinced doubters that his economic reform remains in the Marxist agenda:

“A planned economy is not equivalent to socialism, because there is planning under capitalism too; a market economy is not capitalism, because there are markets under socialism too. The essence of socialism is liberation and development of the productive forces, elimination of exploitation and polarization, and the ultimate achievement of prosperity for all.” (Deng 1992, p. 94)

The similar thought was echoed in Deng’s other speeches and that of his adherents. Those Dengist discourses weakened the resistance against Western accounting ideologically. People started to view accounting as an integrate means to facilitate the economic construction rather than its ideological designation. Take the principle conservatism as an example, in the late 1980s, conservatism began to be adopted in a limited way by commercial enterprises. In 1992, conservatism was stipulated as a principle in the Accounting Standards for Business Enterprises (ASBE) to revamp the traditional uniform accounting system. (MOF 1992) By the end of 2000, conservatism has been fully adopted in ASBE to replace the industry-specific and ownership-oriented accounting systems (Ezzamel, Xiao et al. 2007, p. 691).

Third, the economic reform allows various ownership forms for the socialist production. Private ownership was and is a politically sensitive topic; hence the economic reform was not described as privatization in the CPC literature. The Theory of Preliminary Socialism (1978) regarded private ownership a necessary and beneficial supplement to public ownership (Zhao 1987). Consequently private enterprises, co-operatives and foreign joint ventures co-existed with SOEs and occupied a notable proportion in nation’s economy. The reform of a share system of ownership and the development of organized stock exchanges were intensified. Two nationwide stock exchanges were established in Shanghai in December 1990 and in Shenzhen in July

1991 respectively (Wu 2001). The ownership change provided a space for circulating discourses promoting Western accounting concepts. The re-emergence of the capital market and the difficulties with traditional Chinese accounting provided direct incentives and pressures for market-oriented financial disclosure. Since the release of *Accounting Standards for Business Enterprises* (ASBE) and *thirteen new industry-specific accounting regulations (systems)* in 1992, the Chinese Ministry of Finance has issued a series of accounting regulations with an aim to standardize accounting practices in China and harmonize them with the equivalent IFRS. The new CAS promulgated in 2006 was a significant progress toward the convergence of international accounting standards (Jun and Tweedie 2006).

Conclusion

The discourses in forms of speeches, regulations and articles by prominent politicians, regulators, academics and practitioners disseminate political ideology into the domain of accounting. The distinct appraisals of accounting from different ideological lens, (e.g. the nature of capital exploitation under Mao and a technology under Deng), reflects that how easily that accounting could be de-legitimized and moulded. The notion that accounting is neutral is contestable when connected to the constituted context. There would be doubt that those factors that have been presumed to constitute accounting could reflect accurate images of a concrete reality; instead they produce truth effects in a politically driven way. Ezzamel *et al* (2007, p. 697) demonstrate that “ideological transition opens up a space that facilitates greater debates of regimes of truth.”

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