

Faculty of Commerce

Faculty of Commerce - Papers

University of Wollongong

Year 2007

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

Y. Zhang*

J. Andrew†

H. W. Collier‡

*University of Wollongong

†University of Wollongong, jandrew@uow.edu.au

‡University of Wollongong, collier@uow.edu.au

This paper was originally published as Zhang, Y, Andrew, J and Collier, HW, The Convergence of IFRS in China: A view on the influence of political ideology on Chinese accounting profession, Proceedings of the ACE International Conference, Hong Kong, 12-14 December 2007.

This paper is posted at Research Online.

<http://ro.uow.edu.au/commpapers/368>

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

Zhang Ying, MPA, University of Wollongong

Jane Andrew, Lecturer, University of Wollongong

Henry W. Collier, Hon Research Fellow, University of Wollongong¹

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 comprehensive and to contain true information. This paper tries to explain why and how China moved from a uniform national 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 Reporting Standards (IFRS), or to base their local standards on IFRS. China, as 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 any 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 from agendas that have been 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 in 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 uses 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 with the establishment of People's Republic until the opening-up and economic reform introduced in 1978 China was substantially ruled by Mao Tse-Tung's regime. The Soviet accounting model provided important guidelines for the Maoist regime (Hilmy 1999). As a typical phenomenon at the time, the battleground of accounting research was not vested in academic or practical considerations, but in politics. The political reality was Mao's philosophy that strong central leadership and nationally upheld principles are 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 the journal "New Accounting", Huang claims that "...different socio-economic systems bring 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, this claim was re-interpreted into debates such as "different classes should have different accounting systems", "accounting belongs to class" and "accounting is class-based". 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 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 high profits are 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 input 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 served to ensure that, regardless of cost, the plan’s goals were achieved (Hilmy 1999). The Maoist discourses that 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

² Although since 1956 there had 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-level and the provincial-level governments.

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 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 the SOE, conservatism was deemed unnecessary. Some regulators even believed that there was no accounting for an individual SOE, but only for the one for the national economy (Ezzamel 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). Mao refused to hear or listen to bad news. Lies and exaggerations prevailed (Wang 1992, p. 149) because 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 completely rejected during the movement when sky-high yields and outputs filled the press and enterprise reports (Yang 1998).

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

decentralized administrative power and decision making 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 decision making 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 – The Cultural Revolution.

The fear 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 year period, millions of people were exiled to villages or labour camps to “thought rectify” (Jopson 2006). Chaos multiplied in schools and universities. Profits or costs were not taken into account in manufacturing where products were produced only for to meet political objectives. 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 desire for better economic well-being seized political power and became China's leader. An overall economic reform and "opening-up" policy has been 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 of Mao's society were 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 open to judging a construct based on its socialist or capitalist orientation that any means, regardless of political designation, could be used to develop socialist production. The class struggle orientation has become even more vague 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 requirement 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

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.

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 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 were encouraged to exaggerate profits to meet targets set by the State. Such a view might be charged as a serious political offence before the change.

However, during the early stage of the economic reform, the debate about conservatism remained because of the enduring influences of previous political campaigns under Mao. People were still afraid of

⁴ Under the theory, those private entrepreneurs that were regarded as the Party’s revolutionary 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 its dangers to the Party.

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 central task of 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 supply and demand in the market rather than centrally planned by the State.

The Planned Commodity Economic Theory proposed by the CPC (1978) in 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 that were established under the planned economy model were not suitable for the

development of a commodity economy and were incapable of reporting on or guiding economic reform.

In 1992, Deng visited some coastal cities in southern China and released a series of speeches. Those speeches reassured the people's confidence in the 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)

Similar thoughts were echoed in Deng's other speeches and that of his adherents. Those Dengist discourses weakened the resistance against Western accounting ideology and practice. People began to view accounting as an integrated means to facilitate the economic construction rather than its ideological designation. Take the principle of 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 et al. 2007, p. 691).

Third, the economic reform allows various ownership forms for 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 reforms in 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 molded. 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.”

References:

- Canning, J. B. (1929). The economics of accountancy: a critical analysis of accounting theory. New York, Roland Press Co.
- Choi, F. D. S. (1973). "Financial disclosure in relation to the European capital market." The International Journal of Accounting(Fall): 53-66.
- Clapp, C. L. (1967). "National variations in accounting principles and practices." The International Journal of Accounting **3**(1): 29-42.
- CPC (1978). Communique of the third plenary session of the 11th central committee of the CPC, Beijing: CPC Central Committee.
- CPC (1981). A resolution on several historical issues of the party since the foundation of the PR of China. Beijing, CPC Central Committee.
- Deng, X. (1977). "Two whatevers" do not conform to Marxism. Selected works of Deng Xiaoping. Beijing, The People's Press.
- Deng, X. (1978). A speech made at the National Science and Technology conference. Selected works of Deng Xiaoping. Beijing, The People's Press. **2**: 85-100.
- Deng, X. (1992). Main points of speeches made in Wuchang, Shengzhen, Zhuhai and Shanghai. Selected works of Deng Xiaoping. Beijing, The People's Press. **3**: 370-383.
- Ezzamel, M., J. Z. Xiao, et al. (2007). "Political Ideology and Accounting Regulation in China." Accounting, Organizations and Society **32**: 669-700.
- Gilman, S. (1939). Accounting concepts of profit. New York, Roland Press.
- Grady, P. (1965). Inventory of generally accepted accounting principles of business enterprises, Accounting Research Study 7, American Institute of Certified Public Accountants (AICPA).
- Gu, Z. (1982). Theoretical issues in socialist accounting. Shanghai, Shanghai People's Press.
- Hatfield, H. R. (1927). Accounting: its principles and problems. New York, D. Appleton & co.
- Hilmy, J. (1999). "Communists among us in a market economy: accountancy in the People's Republic of China." The International Journal of Accounting **34**(4): 491-515.
- Jia, H. (1987). "Tentative arguments on the establishment of the "prudence principle" suited to china's condition." Accounting Research (in Chinese)(4): 33-36.

- Jun, W. and D. Tweedie (2006). Joint Statement of the Secretary-General of the China accounting standards committee and the chairman of the international accounting standards board, Beijing.
- Mao, T. (1993). On the ten big relations. Selected works of Mao Tsetung (Vol. 5). Beijing, China, People's Press.
- MOF (1992). Accounting Standard for Business Enterprises, The Ministry of Finance.
- Mueller, G. G. (1968). "Accounting principles generally accepted in the United States versus those generally accepted elsewhere." The International Journal of Accounting **3**(2): 93-102.
- Paton, W. A. (1922). Accounting theory - with special reference to the corporate enterprise. New York, Roland Press Co.
- Paton, W. A. and A. C. Littleton (1970). An introduction to corporate accounting standards, American Accounting Association.
- People's Daily. (2007). "China to insist on reform, opening-up for harmonious society." Retrieved 11 October, 2007, from <http://english.cpcnews.cn/>.
- PricewaterhouseCoopers. (2006). "PricewaterhouseCoopers Commentary China Accounting Standards Convergence with International Financial Standards - "Best or Worst of Times?"" Retrieved April 19, 2007, from http://www.pwchk.com/home/eng/pr_160206.html.
- Ren, X. (1998). China's administrative reform. Hanzhou, China, Zhejiang People's Press.
- Wang, W., Ed. (1992). An encyclopedia of socialism with Chinese characteristics. Tianjing, China, Tianjing People's Press.
- Wu, H. (2001). Legal adjustment of the development of China's securities market (in Chinese). Beijing, People's Publishing House.
- Xiao, K. (1998). The political campaigns I experienced (In Chinese). Beijing, Zhongyang bianyi chubanshe.
- Xin, Z. and S. Huang (1951). "How to Construct New China's Theoretical Accounting Basis." New Accounting (in Chinese)(1): 12-16.
- Xinhua. (2007). "Chinese president stresses social harmony in New Year Address." Retrieved 11 October, 2007, from http://english.peopledaily.com.cn/200701/01/eng20070101_337451.html.
- Yan, J. (1951). "Criticizing Tao De's 'My Reading of 'How to Construct China' Theoretical Basis of Accounting'." New Accounting (in Chinese)(1): 19-20.
- Yang, S. Z. (1998). The Evolution of Chinese Accounting: 1949-1992. Beijing, China Finance and Economic Press.

- Yu, G. (1981). "On the nature of accounting." Accounting Research (in Chinese)(3): 44-49.
- Zhang, H. Z. (1991). "Conservatism is an inappropriate accounting principle in China." Finance and Accounting Research (in Chinese)(5): 21-22.
- Zhao, Z. (1987). Marching along the socialist road with Chinese characteristics. Political Report to the 13th National Congress of the CPC. Beijing.