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Fair value accounting in China: neoliberalisation and accounting change

Ying Zhang
University of Wollongong, eagle@uow.edu.au

Jane L. Andrew
University of Wollongong, jandrew@uow.edu.au

Kathleen M. Rudkin
University of Wollongong, krudkin@uow.edu.au

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Abstract

This paper explores the tension between neoliberal theory and practice by using China as an example. This paper investigates the implementation of Fair Value Accounting (FVA) in China and argues that market share prices are not 'fair values' of companies' financial position as theories of FVA assume, rather, they project only the distorted share price movements caused by the strong intervention of the Chinese government with its multiple and often competing agendas. By positioning this regional event in a broad neoliberal context, this paper argues that the accounting term 'fair value' is imbued with assumptions about the state and the market that have little bearing on the realities of a Chinese capital market. The impacts the adoption of FVA has had on Chinese capital markets demonstrate that, rather than advancing the public interest in China, the adoption of FVA has not transformed political and economic power. Instead, it has provided another opportunity to reposition powerful political and economic elites both inside and outside China. The process has reconfigured capital markets in the image of those in advanced capitalist economies, but is devoid of the regulatory and socio-political context apparatus to rationalise its relevance and reliability in the Chinese context.

Keywords

Fair, value, accounting, China, neoliberalisation, accounting, change

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FAIR VALUE ACCOUNTING IN CHINA: NEOLIBERALISATION AND ACCOUNTING CHANGE

Ying Zhang*
Lecturer
University of Wollongong, Australia
Email eagle@uow.edu.au

Jane Andrew
Senior Lecturer
University of Sydney, Australia
Email J.Andrew@econ.usyd.edu.au

Kathy Rudkin
Senior Lecturer
University of Wollongong, Australia
Email krudkin@uow.edu.au

* Corresponding author.

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ABSTRACT

This paper explores the tension between neoliberal theory and practice by using China as an example. This paper investigates the implementation of Fair Value Accounting (FVA) in China and argues that market share prices are not ‘fair values’ of companies’ financial position as theories of FVA assume, rather, they project only the distorted share price movements caused by the strong intervention of the Chinese government with its multiple and often competing agendas. By positioning this regional event in a broad neoliberal context, this paper argues that the accounting term ‘fair value’ is imbued with assumptions about the state and the market that have little bearing on the realities of a Chinese capital market. The impacts the adoption of FVA has had on Chinese capital markets demonstrate that, rather than advancing the public interest in China, the adoption of FVA has not transformed political and economic power. Instead, it has provided another opportunity to reposition powerful political and economic elites both inside and outside China. The process has reconfigured capital markets in the image of those in advanced capitalist economies, but is devoid of the regulatory and socio-political context apparatus to rationalise its relevance and reliability in the Chinese context.

Keywords: Fair Value Accounting; Neoliberalism; Free Market; Chinese Accounting Standards; Chinese Capital Markets; Government Intervention.

1. INTRODUCTION

> While many general accounts of global transformations and their effects are now available, what is generally missing…is the political-economic story of where neoliberalization came from *and how it is proliferated on the world stage* (Harvey, 2005, p.4 emphasis added).

Fair Value Accounting (FVA) has been incorporated into contemporary accounting practices of Chinese listed companies since China harmonised its accounting standards with International Financial Reporting Standards (IFRS) in 2006 (Deloitte 2006). The new Chinese accounting standards – also named *Accounting Standards for Business Enterprises* (ASBE) consist of a new Basic Standard and 38 specific ASBEs, 17 of which specifically adopt FVA as either an initial or subsequent recognition and measurement method (Wang 2007). It should be noted that FVA was completely prohibited in previous ASBE's before harmonisation with IFRS. Therefore, many Chinese accounting academics (e.g. See Ge 2006; Liu and Zhang 2006; Wang 2006; Lu et al. 2007) regard FVA as the major change between the previous standards and new ABSE's after convergence. Even though China's move to FVA considerably impacts on share prices and changes financial reports, as this paper presents, it is presented by media within China as a remarkable development for China's economy and its place in world capital markets (Zhang et al. 2009). As such, a joint statement by the Secretary-General of the China Accounting Standards Committee and the Chairman of the International Accounting Standards Board (IASB 2005), claims that establishing and improving a single set of high quality global accounting standards is the logical consequence of the trend of economic globalisation, and that is a goal to which the IASB as well as national accounting standard setters of all jurisdictions should continue to make sustained efforts to achieve.

In spite of the significance of this massive accounting change, there is a lacuna of research documented in English about the move to FVA in China. This study contributes to the literature providing insights on the deeper ideological motivation of FVA and its far-reaching influences on China's socio-economic transformation. In part, the paper follows up Harvey's (2005) call for a deeper understanding of the mechanism used to grow neoliberalism internationally. We argue that FVA is a significant technology of neoliberalism and the contrast presented by the values it promotes in the Chinese context enable a new understanding of neoliberal processes.

This paper is structured as follows. Section two presents a theoretical discussion of FVA and its connection with neoliberalism. Section three provides a discussion of the implementation of the FVA in China, which serves to further support and illustrate what has been theorised about FVA and neoliberalism in this paper. Section four draws conclusions.

2. FAIR VALUE ACCOUNTING AND NEOLIBERALISM

2.1 What is Fair Value Accounting

FVA requires a substantial portion of a reporting entity's assets and liabilities in the balance sheet to be recognised at 'fair value', and changes in the 'fair value' of assets

and liabilities are recognised and flow through the income statement or equity section of the balance sheet each period (Ernst & Young 2005; King 2006; Zack 2009).

'Fair value' is defined by IASB (2006, p. 8) as "[t]he amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction". IASB published in June 2009 an Exposure Draft for Fair Value Measurement in which proposes to change the definition of 'fair value' as "[t]he price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date." (IASB 2009, p. 4) This proposed definition is identical with the one defined by the current (2010) US Financial Accounting Standard Board (FASB) Statement of Financial Accounting Standards (SFAS) No. 157 *Fair Value Measurements* (FASB 2008, p. 6). This certainly reflects the US influence over the IASB in the development of Fair Value based standards.

Contrary to the historical cost model, FVA requires that the assets acquired and liabilities occurred are reported on the balance sheet at prices that would be adopted in current market transactions at the measurement date; and that the increases or decreases in the hypothesised 'prices' of assets and liabilities are recognised as incomes and expenses in Income Statements. This is a controversial issue that has been strongly contested within the accounting literature (e.g. O'Malley and Hofste 2003; Barth 2004; Landsman 2007; Penman 2007; Ronen 2008; Sunder 2008; Whittington 2008; Zack 2009).

2.2 Fair Value – a value-laden term

This paper seeks to raise the discursive position of the notion of fairness that FVA contains. The connotations of the label "fair" are influential because "Fair Value" is a powerful and persuasive expression. It is difficult to counter an argument for 'fairness' and correspondingly, a reporting method that relies on the use of 'fair' value[1].

'Fair Value' is essentially a particular version of 'Current Value'. Some (e.g. Barth and Landsman 1995; Mard et al. 2007; Benston 2008; Ronen 2008; Zack 2009) argue that by emphasising the price to "sell an asset", the accounting standard setting bodies have chosen the exit value (as opposed to entry value) version of 'current value' rule. The value determined is the amount required to exchange the asset or liability in an orderly transaction between market participants. Exchange means to sell the asset or transfer the liability at the measurement date. An orderly transaction assumes exposure to the market for a period prior to the measurement date to allow for

[1] Sunder (2008) illustrates two interesting examples of the power of semantics: 1) President Johnson wanted to use the Social Security Trust Fund surpluses to finance increased spending on Great Society programs and the Vietnam War. He sent legislation labelled Unified Budget Act to Congress, forcing his opponents to have to argue for a non-unified budget; 2) after the 9/11 attacks, President Bush wanted to place limits on certain civil liberties to fight the War on Terror. He sent legislation labelled the Patriot Act to Congress, forcing those worried about civil liberties to appear to be arguing against patriotism. This is an old game of political rhetoric, as described by Sunder (2008, p. 112): "[u]sing clever labels to put the opponents of your proposal on the defensive before the debate even starts".

marketing activities that are usual and customary. In this sense, an exit price is based on a hypothetical transaction from the perspective of a market participant who holds the asset or owes the liability. Therefore, the objective is to determine the price that would be received to sell (rather than to purchase) the asset or paid to transfer to (rather than to take over) the liability at the measurement date, which makes it an exit price. This essence becomes, however, less obvious when this concept is labelled by the new term – Fair Value, a very powerful and heavily value-loaded label.

The discursive representation of 'Fair' itself is a dynamic term because the reality of the fairness is socially-constructed with specific conceptions ascribed by the society (Hines 1988; Dillar 1991); something which is 'fair' to someone might not be so 'fair' to others. As Penman (2007, p. 34) illustrates: "Different users may demand different accounting reports, and confusion reigns if issues are discussed at cross purposes. A shareholder might recognise a gain from a fall in the market value of debt as creditworthiness deteriorates, but not the creditor; bank shareholders might wish to see bank deposits at fair value, but not the depositors; a bank regulator would also be concerned about reporting deposits at less than face value if such reporting affected depositors' confidence in the banking system; while an investor might welcome the information about volatility that fair value accounting reveals, not so a central banker who might be concerned about feedback effects on systematic risk; a bank regulator might be concerned about marking up banks' capital during speculative times with the resulting incentive for profligate lending." Considering the inevitable partiality that this term is denoted, it is necessary to question why this particular type of current value is regarded as 'fair' value and what possible ideological assumptions frame this belief.

2.3 A Neoliberalised value

FVA assumes a free market which, this paper argues, has been heavily influenced by neoliberal ideology and is one of its many practical manifestations. Neoliberalism, as Harvey (2005, p. 2) defines, is "in the first instance a theory of political economic practices that proposes that human well-being can best be advanced by liberating individual entrepreneurial freedoms and skills within an institutional framework characterized by strong private property rights, free markets, and free trade." In the social sciences, it is widely agreed that neoliberalism has become the primary force that has shaped different aspects of contemporary societies (Ong 2006).

In theory, neoliberalism centres on the relationship between the state to the market. It builds on the foundation of classical economic liberalism, that assumes markets efficiently utilise economic resources and optimally serve all economic needs if they are allowed to function without restraints (Smith 1961; Friedman 2002). By suggesting that markets are superior to other social mechanisms for allocating resources and organising the economy, neoliberal theories provide a rationale for neoliberalism's opposition to state interventionist theories such as the Keynesian approach. Using the concept of 'trickle down', neoliberals believe that overall output growth improves living standards for all people as a whole. It is argued that the improved economic opportunities will 'trickle down' even to the poorest (Harvey 2005; Johnston 2005). A further extension of this doctrine argues that the

globalisation of free markets is the best way to extend these benefits to the whole world. In this sense, Moore as cited in Shaikh (2005, p.41), former Director General of the World Trade Organisation, stated “the surest way to do more to help the [world’s] poor is to continue to open markets”.

Although neoliberalism, in theory, promotes less states intervention and more market freedom, ‘really existing’ operates very differently. Neoliberals recognise that an ideal market order requires a particular kind of state to secure it (Rapacynski 1996; MacEwan 2005; Munck 2005; Gamble 2006; Ong 2006), this being a point of difference with classical economic liberalism. It is argued the best rules and conditions for markets to flourish include: deregulation of financial markets, privatisation, weakening of institutions of social protection, weakening of labour unions and labour market protections, shrinking of government, cutting of top tax rates, opening up of international goods and capital markets, and abandonment of full employment under the guise of the natural rate (Friedman and Friedman 1980; Munck 2005; Palley 2005; Gamble 2006). It should be noted that the ‘deregulation’ advocated by neoliberalism is actually a different kind of regulation to overcome the obstacles and resistance to the institutions of a free economy. As cautioned by MacEwan (2005, p. 172) “neoliberalism requires a strong state that can ensure the primacy of private property, preserve the dominance of markets over social control, and thus limit the operation of democratic power. Also, neoliberalism often requires a strong state, sometimes a dictatorial state, for its implementation.”

The reform path that China is undertaking since the late 1970s has aligned itself with this broader neoliberal context. The extant literature illustrates the following major characteristics of China’s economic reform: 1) the establishment firstly of ‘markets’ in the economy adhering to a central-plan and public ownership (Shirk 1993; Solinger 1993; Wang 1994); 2) the expansion of the markets by fostering international trade and opening up domestic markets for overseas capital (Lardy 1995; Gao 1996; Prasad and Wei 2008); 3) the massive privatisation of public assets and State-Owned Enterprises (Krug 1997; Song 2004; Guthrie 2006); 4) the substantial withdrawal of the government from social welfare provision (Wang 2003; Harvey 2005; Ong 2006); 5) an active participation in the world economy by seeking membership of international organisations such as the WTO (Garnaut et al. 2001; Song 2004); 6) the voluntary convergence of domestic standards with international ones, such as the IFRS (Zhang et al. 2009). The signal being sent from these activities is apparent that China wants to embed its new economic system in a more ‘free market’ pattern. Positioning this in the neoliberal context, China has been deliberately establishing a particular type of institutional arrangement that enables the economy to operate ‘freely’. This kind of neoliberal approach, however, has been increasingly challenged.

2.4 The political nature of neoliberalism

Those critical of neoliberalism as it has been ‘theorised’, have argued that markets will never work in a textbook manner (Clarke 2005; Munck 2005; Shaikh 2005; Harrison 2006; Robison 2006). Gamble (2006, p. 28) points out that “[s]ince all power corrupts, even the most selfless neoliberal government will soon find itself

taking decisions which benefit the interests of the state or of corporate interests rather than those of the wider public."

In the first place, the establishment of markets, or referring to Munck (2005, p. 61) "the making of markets", has always been a contested political process and not a natural event as neoliberals believe. Karl Polanyi, commenting on the 19th century Industrial Revolution, proposes that "the emergence of national markets was in no way the result of the gradual and spontaneous emancipation of the economic sphere from governmental control" (Polanyi 1957, p. 258), rather, "the market has been the outcome of a conscious and often violent intervention on the part of government which imposed the market organisation on society for non-economic ends" (Polanyi 1957, p. 258). In the context of contemporary economic globalisation, for instance, the establishment of the global market has required a whole set of international rules established to regulate the vast volume of international trade in terms of contract law, patents and arbitration procedures. This mechanism has been facilitated by and negotiated among the powerful states of the world such as that has been experienced in the operation of the World Trade Organisation. Politics always plays a significant role in this early process.

This has been far less ambivalent in neoliberal projects. While advancing policies of 'deregulation' (removal of state regulatory systems that intervenes the markets), neoliberalism reconfigures regulation with market-oriented rules and policies to facilitate the development of a new form of capitalism, in which there are clear winners and losers. Following on from these neoliberal policies, capital mobility has been facilitated, free trade has been sanctified, labour has been made more 'flexible' and macroeconomic management has become fully market compliant at an international level (Munck 2005). All these could be viewed as a shift in power relations between capital and labour. Kalecki (1943) illustrates, in an analysis of the political import of Keynesianism, that if governments commit themselves to policies of full employment it then means a significant weakening of the normal capitalist disciplines of bankruptcy and unemployment and a huge increase in the bargaining power of organised labour, particularly with regard to wages. On the contrary, the spread of neoliberal policies, as the next section shows, has indeed led to a surge of the power of financial capital over labour and production across the world over the past decades (Gamble 2006).

2.5 The power of financial capital

On the global stage, capital escapes from high taxing and inflexible labour markets into a world of deregulated global markets where former public ownership and monopoly are opened up. It has been pointed out that the shift of power and influence in business from the old manufacturers to new sectors of capital, especially in the finance and banking sector, has been a central feature of the neoliberal change since the 1970s (Harvey 2005; Robison 2006). To reiterate this, Harvey (2005, p. 33) wrote that "[t]he support of financial institutions and the integrity of the financial system became the central concern of the collectivity of neoliberal states (such as the group comprising the world's richest countries known as the G7). In the event of a conflict between Main Street and Wall Street, the latter was to be favoured…While the slogan

was often advanced in the 1960s that what was good for General Motors was good for the US, this had changed by the 1990s into the slogan that what is good for Wall Street is all that matters." The policy response to the global financial crisis and its impact on both Main street and Wall street saw an acceleration of state intervention to ensure the ongoing survival of both institutions. Much of this was couched in terms of 'social benefit' whilst under reporting the long term social debt that resulted from risk exposed capital markets seeking to minimise the consequences of excessive financialisation.

A great deal of works in this field (see, e.g. George 1988; Wade and Veneroso 1998; Clarke 2005; Harvey 2005) demonstrate that neoliberalisation allows the financial system to become one of the main centres of redistributive activity. There is also strong evidence (see, e.g. Harvey 2005; Panitch and Gindin 2005; Soederberg 2005; Toporowski 2005) to support the view that the neoliberal moves expand the impoverishment of those less privileged and open up untrammelled market freedoms for powerful corporate interests, significantly proliferating the redistributive effects and increasing social inequality across and within different societies. Much research on the social impacts of neoliberalism (see, e.g. Wang 2003; Harvey 2005; Ong 2006; Klein 2007) notes new processes of class formation emerging: the rise of finance and financial services producing a surge in the remuneration of CEOs of financial corporations; new sectors such as biotechnology and information technologies allowing individuals in advanced economies to accumulate unprecedented fortunes, such as Bill Gates and Paul Allen; a privileged relationship to state power has made those such as the Suharto family or the newly emerged Chinese entrepreneurs with Chinese Communist Party (CCP) background immensely rich; the privatisation of public assets has re-allocated wealth into the possession of a small group of individuals, as exemplified by Russia's notorious oligarchs or 'the princelings' in China; among many others.

2.6 The link between FVA and neoliberalism

In light of the previous discussion, this paper believes that the rise of the FVA has been consistent with the development of a neoliberal economy. The comprehensive adoption of FVA is a recent phenomenon, although early reference to the term fair value in the context of accounting standards setting dates back to as early as 1953 in the U.S. with the issuance of Accounting Research Bulletin 43 – Restatement and Revision of Accounting Research Bulletins (Fishman et al. 2007). Referencing to Fishman et al. (2007)'s study, however, not until the mid1980s the term was often mentioned with providing neither a definition nor guidance on how to measure it.

In 1986 FASB added a project to its agenda on financial instruments and off-balance sheet financing, which ultimately led to the issuance in 1991 of SFAS 107, *Disclosures about Fair Value for Financial Instruments* and the issuance in 1998 of Financial Accounting Standards 133, *Accounting for Derivative Instruments and Hedging Activities* (FASB 2004). Since June 2004, the FASB Exposure Draft, *Proposed Statement of Accounting Standards – Fair Value Measurements* (paragraph C4), the FASB started to define and scope the fair value standard primarily for reporting of financial instruments.

Another major reason identified by Fishman et al. (2007), of the emerging demand of FVA is the shift of the U.S. economy toward service-oriented and information-oriented businesses during the 1980s. During this period, the shares of some public companies began trading at increasingly higher multiples of "book value" and this was explained as being the result of recognition of "intangible" values including intellectual property. Lack of sufficient guidance on how to measure the fair value of assets and liabilities to cope with the new progress of capital markets led to diversity of practice and hence potential manipulations in financial reporting. Many cases of abuse arose (see Fishman, Pratt et al. 2007, p. 251). For example, these abuses were noted in the valuation and write-offs of large amounts of in-process research and development for business combinations in the technology sector in the mid- to late 1990s.

Accounting organisations and rule-making bodies were increasingly facing pressures to deal with this measurement issue (Day 2000; King 2006). In the U.S., for instance, the SEC since the late 1990s has continued to voice its opinion to AICPA for developing detailed, broad-based guidance on valuation models and methodologies used to measure fair value in financial reporting (Day 2000). As a result the guidance on fair value for financial reporting has increased substantively. In 2000 the FASB issued FASB Concepts Statement No. 7, *Using Cash Information and Present Value in Accounting Measurements*, which was the result of a project the FASB had added to its agenda in 1988 to consider present value issues in accounting measurements[2]. Referring to the increased amounts of merger and acquisition activity as a principal reason, the FASB undertook a new project in 1996 related to accounting for business combinations, which resulted in the issuance in 2001 of SFAS 141, *Business Combinations*, and SFAS 142, *Goodwill and Other Intangible Assets*. Both of these statements provide more specific guidance on fair value than did previous standards. The similar examples are Statement of Auditing Standards (SAS) 101, *Auditing Fair Value Measurements and Disclosures* issued in 2003 and the Valuation Resource Group (VRG) formed in the same year to provide a standing resource to the FASB on fair value measurement issues[3]. In its June 23, 2004 Exposure Draft on measuring fair value, FASB indicates its long term agenda to establish a framework that clarifies measurement of fair value in a manner that can be consistently applied to <u>all assets and liabilities</u>[4]. In terms of the IFRS' framework on the fair value issue, IASB has expressed explicitly that it follows closely with FASB on developing the standards of fair value measurement (IASB 2009).

To get to the point, the increasing importance of those financial instruments and the shift into high-tech and information-orientated economies factors have significantly influence the rapid progress of accounting standards on fair value measurement. These two factors are significant dimensions of the contemporary neoliberal economy. Further, as previous sections have provided, FVA assumes a significant faith in the market mechanism, aligning it with the kind free-market fundamentalism that has

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[2] FASB Concepts Statement No. 7, *Using Cash Flow Information and Present Value in Accounting Measurement*, paragraph 2. See: http://www.fasb.org/pdf/con7.pdf.
[3] June 23, 2004 FASB Exposure Draft, *Proposed Statement of Accounting Standards – Fair Value Measurements*, paragraph C13. See www.fasb.org.
[4] June 23, 2004 FASB Exposure Draft, *Proposed Statement of Accounting Standards – Fair Value Measurements*, paragraph C4 and C11. See www.fasb.org

been propagated by neoliberalism. It is, thereby, suggested that FVA is an accounting method that is heavily invested with neoliberal values, and it is a manifestation of neoliberalism. It has been promoted and actively adopted by accounting regulators across the world despite its shortcomings and its volatility. The standard setting bodies have been driven by (or possibly pushed actively with other organisations) this broad institutional force to move to a full endorsement of FVA.

Since neoliberalism does not necessarily bring about desirable social outcomes (Harvey 2005; Klein 2007), this neoliberalised accounting model is subject to the same judgement of its broader settings. In order to further illustrate this broad argument, remainder of this paper focuses on the implementation of FVA in China as an example of how neoliberal processes a promoted and promulgate in context.

3. FAIR VALUE ACCOUNTING IN CHINA

For China to adopt the FVA there are a number of hurdles to overcome. China is still a long way from achieving a well-functioning capital market, with transparent financial information exchange. The legal system is often ill-defined, and regulatory agencies provide only limited accountability (Song 2004; Yip 2006). As the market through which the fair value is obtained is different in China, it is likely that this context will affect the way FVA operates. Given this context, it is questionable whether FVA will provide a better representation of value in Chinese companies' financial reports. Given these questions, and the possibility that FVA is an inappropriate method of valuing assets in the current institutional context in China, it is also important to consider why China has made such a bold move. An exploration of the answer, as this paper believes, provides further insights and challenges to the penetration of neoliberalism in China's accounting change.

3.1 The Chinese Capital Markets and the Fair Value Accounting

This paper focuses on *Accounting Standards for Business Enterprises (ASBE) No. 22 Recognition and Measurement of Financial Instruments*, which is equivalent to *IAS 39 Financial Instruments: Recognition and Measurement*. The reason is because ASBE No. 22 is the major standard, as shown later, that brought about the most significant changes to Chinese listed companies' financial reporting after the promulgation of the new CAS. It, hence, provides a strong focus so that the very broad and comprehensive research topic this paper tries to explore is able to be reflected and evaluated.

In order to understand how ASBE No.22 operates in China, it must refer to Chinese capital markets because they are the places where the 'Fair Values' are drawn from. Under the standard, the financial assets are to be measured at their fair values and any variation is recorded in the profits and losses of the current period (Chinese Accounting Standards Committee 2009). Under the current IASB framework, the

'Fair Value' mainly refers to the observable market prices (see Section 2 of this paper).

The performance of Chinese capital markets over the past five years has been dramatic and volatile. The market had remained stable until the end of 2005. However, since early 2006, the markets started to rise unexpectedly. The Shanghai composite index increased continuously from 1200 points in January 2006 to the highest point 6092 points in October 2007 – a jump of 407.67% in less than two years. The markets stared to fall after that. The Shanghai Composite Index decreased from 6092 points on October 16, 2007 to 1728 points on October 31, 2008 – a fall of 71% in about one year. Since then the markets have been relatively stable with the index number never exceeded 3400 points until January 2010[5].

The adoption of the FVA has significantly changed the financial reporting of Chinese listed companies due to the severe turbulence in Chinese capital markets between 2006 and 2008. In 2007, there were 1135 listed companies holding other companies' shares, accounting for about 78% of total listed companies on the Shanghai and Shenzhen Stock Exchange (Shi 2007). Li, Xiao-Xue (2007), the secretary of China Securities Regulatory Commission, admitted that about one third of the increases of profits of listed companies in 2007 came from the fair value changes in the cross-holding shares of other listed companies.

Under the new standard, listed companies' profits were boosted greatly by the strong performance of the capital markets between 2006 and 2007. The consequent increase in investors' confidence also pushed up the share prices, which seemed a very positive development. However, after the market reached the historical peak 6092 points in October 16, 2007, it started a free fall from there to 1728 points on Oct 31, 2008 – a fall of 71.63% in about one year (Shanghai Stock Exchange, www.sse.com.cn). This dramatic change had been reflected in listed companies' accounting reports as well. To reference some examples: the Livzon Group – one of the leading pharmaceutical companies in China (listed in ShenZhen Stock Exchange:000513), reported net profits for the first quarter of 2008 were reduced by 73.53% compared to the same period the previous year; although the net profits from operating activities were 142.18 million Yuan, an increase of 34.19% compared to the period of 2007. The fall in prices of those cross-holding shares contributed a loss of 170.85 million Yuan (Wang 2008). Similarly, China Credit Trust Co., Ltd – a major non-banking financial institution, reported a half year loss of 317 million Yuan while last year it had a profit of 931 million Yuan (Huang 2008). The biggest contributor to the loss was the fair value changes in those cross-holding shares. The huge volatility is clearly a result of the adoption of the FVA.

Supporters of FVA might argue that it is crucial that firms report those value changes to reflect the underlying economic substance given the mediative function of capital markets. The theory supporting this assumption is that capital markets have a key role in the overall corporate governance of modern firms, which establishes a real relationship between the markets and the physical economy (Young and McGuinness 2001). Evidence from the fall out of the global financial crisis would suggest that the link is often tenuous even in well established capital markets, let alone the operation

[5] The index numbers are quoted from Shanghai Stock Exchange, www.sse.com.cn.

of China's capital markets. In China's case, however, it is particularly crucial to inspect whether or not such a link between share prices and the real economy exists, which challenges fundamentally the idea that a price derived from this market is a 'fair' price to be adopted in financial reporting.

3.2 Split Share Structure Reform: a background

While the mainstream Chinese discourses blamed the US sub-prime crisis for the market turbulence, there were some alternative viewpoints that argued the fundamental cause of the market crisis was a major reform scheme, namely "Split Share Structure Reform" (SSSR) (e.g. Li 2008; Ma et al. 2008; Wang and Ge 2009; Zhang 2009). These commentators referred to the disastrous effects of the SSSR with a massive selling of non-tradable shares in the markets, which has dominated the market movements over the past five years. If this is accepted, then the assumption of FVA that the observable price obtained from this market is a 'fair value' to be used in financial reporting becomes plausible.

The SSSR is a major measure that the Chinese government has advanced to 'free' Chinese capital markets by transforming the share ownership structure of Chinese listed companies, which has been widely recognised as core factor that caused the market inefficiency in China (e.g. Young and McGuinness 2001; O'Connor et al. 2006; Francis et al. 2009). By June 2005, the total market capitalisation of A-share listed companies[6] in the Chinese share markets was RMB 735.6 billion among which the value of the non-tradable shares (state-owned shares) was RMB 469.4 billion, accounting for 64% of the total capital (Zhang 1992). In other words, only about 36% of shares issued by listed companies were freely available to investors in the markets. There were also very clear quantitative restrictions imposed by the government on the number of companies that could go public or a maximum number of shares that can be issued in a given year[7]. A combination of these restrictions had effectively enabled the government to control the supply of shares to meet its demands over time. These types of government interventions into the capital markets distorted the supply and demand relationship which created volatile and speculative markets in its early period.

The SSSR is claimed to improve the market efficiency by freeing the listed companies from this share ownership constraint. The ultimate aim is to transform all those non-tradable state shares into free float shares. The state's approach is to conduct the reform step by step. The first step is to change the non-tradable state-owned shares to tradable shares in name, but those shares could not be traded in the markets

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[6] There are two types of shares that could be tradable in Chinese capital markets. **A shares**: companies incorporated in mainland China and are traded in the mainland A-share markets. The prices of A shares are quoted in RMB, and only mainlanders and selected foreign institutional investors are allowed to trade A shares; **B shares**: companies incorporated in mainland China and are traded in the mainland B-share markets (Shanghai and Shenzhen). B shares are quoted in foreign currencies. In the past, only foreigners were allowed to trade B shares. Starting from March 2001, mainlanders can trade B shares as well. However, they must trade with legal foreign currency accounts.

[7] More details of the restrictions could be found in Liu, Q. (2006). A Systematic Research into the Information Disclosure of Chinese Listed Companies and Its Regulation. Economics and Managment. Shanghai, Tongji University. **PhD Thesis**.

immediately, but must wait for a certain period of time[8]. Article 27 of the CSRC(2005)'s Administrative Measures requires that:

> [T]he sale of originally non-tradable shares after the reform plan is completed shall comply with the following provisions:
> (1) The non-tradable shares shall not be traded or transferred within 12 months from the date of implementation of the reform plan;
> (2) A former non-tradable shareholder who holds more than 5% of the total shares of a listed company, upon expiry of the lock-up period as stated in Article 27.1 of the Measures, may sell their shares, with a maximum of 5% of the total shares of the listed company within 12 months via the trading system of the stock exchanges, and not more than 10% within 24 months.

The reform took effect on May 8, 2005 with "four companies including Sany Heavy Industries, Tsinghua Tongfang, Zijiang Enterprises, and Jinjiu Energy [were] chosen as the first pilot companies" (Wan and Yuce 2007, p. 376). According to the rule, shares of those companies were no longer non-tradable state-owned shares in name, but they were still banned from trading for 12 – 24 months, the first float of those previous non-tradable shares weren't traded in the markets until 2007, with most of them to be traded in 2008, 2009 and 2010 (see Table 1 of Appendix). All other listed companies have been arranged to undertake the same reform path at various times since then.

This reform is apparently massive with anticipated fundamental changes into Chinese listed companies and hence the capital markets. As *Section 2.4 – The political nature of neoliberalism* notes, the 'making' of an ideal institutional setting for neoliberal projects embodies remarkable hegemonic relations and undesirable social impacts that have been not transparent in contemporary societies. Harvey, whilst positioning argument in favour of the latter (2005, p.19) has said, "we can…interpret neoliberalization either as a *utopian* project to realize a theoretical design for the reorganization of international capitalism or as *political* project to re-establish the consideration or capital accumulation and to restore the power of economic elites". The following sections reinforce this argument by revealing a stark reality associated with this neoliberal effort of 'freeing' Chinese capital markets – a fundamental condition that is so essential for the implementation of FVA.

3.3 The Split Share Structure Reform: a hidden agenda

The dominating effect of the SSSR on the share prices is connected to the particular design of this reform – the 12 to 24 months lock-up period. In Chinese discourses, the allowance of the liquidation of those tradable shares after passing the lock-up period is referred to as "*JieJin*[9]". Table.1 (see Appendix) is a timetable of the "*JieJin*" which shows that by the end of 2010 most of non-tradable A-shares will pass the lock-up period.

[8] This is interesting because if those shares could not be traded they're still non-tradable shares. The purpose is probably to bring psychologically some buffer effects into the markets by changing the name firstly.
[9] Original Chinese text: "解禁".

The impact of this design on the supply of shares is enormous. Li (2008) indicated that the A-share market capitalisation was about 7.1 trillion Yuan up to April 30, 2008, however, this amount would be increased to 22.6 trillion Yuan which is equivalent to two times the volume of current shares pouring into the markets. Wang (2005, p. 180) also predicted during 2006 to 2008 that:

> [u]nder the policy that requires a 12 to 24 month lock-up period of selling those non-tradable shares after converting into tradable shares, there would be about 37 billion (5% of 740 billion) non-tradable shares become free floats after one year, which even exceeds the total amount of IPO issuing in 2003 and 2004. After the lock-up period, the whole free float would reach 300 billion shares which could all be sold out as long as the market price is greater than the current mean price of 2.8 Yuan/share…those shareholders of non-tradable shares would sell those shares in high, and buy back in low to maintain the control…there would be enormous pressures on the markets in the next three years.

There is an obvious reason for this. Theoretically, the huge difference between the cost price and the market price draws great incentives for the shareholders to liquidate the shares.

There is also research since 2008 concerning the possible relationship between the share price movement and the "*JieJin*". Zhang (2009) identifies that there is a strong connection between shares' price decline and the volume of shares being "*JieJin*". For instance, September 2007 and March 2008 were two months with the greatest amounts of shares being "*JieJin*" so far at one time, and they were the two months where the market experienced significant falls (Zhang 2009, p. 2). Li (2008) indicates that the arithmetic mean price of A-shares was about five Yuan per share by the end of 2005, which increased to over 15 Yuan per share up to April 30, 2008. The average profit of selling those shares was over 200% in just two years which provided absolutely appealing incentive for any shareholders to cash out the gains. That is why Ma et al. (2008, p. 2) warn that "in 2007 the bull market has successfully absorbed the impacts of the '*JieJin*', however, with the increasing amounts of '*JieJin*' and its cumulative effects, if the macro-economic condition deteriorates and the market liquidity couldn't catch up, the markets would suffer an unbearable blow".

A brief comparison of the market turnover from Table 2 (see Appendix) could shed further light on this. For instance, the trading volume was 398.66 billion shares in 2005 which was actually the highest amount over the period before the "*JieJin*" begun; it jumped dramatically to 1,028.39 billion shares in 2006 and 2,432.54 billion shares in 2007 – a leap of 158% in 2006 and 510% in 2007. There has been no information disclosure about how many of the shares circulated were those "*JieJin*"ed ones. There might be various reasons causing the change; however, the effect of "*JieJin*" here was too magnitude to be ruled out given its influence on the supply of shares. The immensely increased volume of shares supplied which has been unprecedented was most likely a result of the massive selling of previously non-tradable shares when they were being allowed to be traded.

This kind of information, however, was not visible to the public more broadly. The PhD thesis and research articles upon which this paper draws are only accessible to researchers with registration and paying access fees. Given the significant regulatory intervention required to construct a functionin g capital markets.The relevant criticisms and debates specifically revealing the potential impacts or risks of the "*JieJin*" on the share prices, were suspiciously sidelined in the public media between 2007 and early 2008. For instance, on the biggest financial website in China – *Sina.com.cn*, there is a specific section: http://finance.sina.com.cn/nz/chinaggzw/3.shtml dedicated to this reform. As at January 2010, the latest news was dated July 16, 2007. There are only five posts in 2007 including only one referring to the reform with a title "Investment Fund Industry: there's limited impact of the Split Share Structure Reform on the market". A browse of nearly 500 posts in 2006 sees that most of the news was about how strong the shares had performed in the bull market. There were only two articles mentioning the issue of "*JieJin*". One was on August 08, 2006 - "The peak time of '*JieJin*' hasn't come yet" which briefly introduces the numbers of shares that would be allowed to be circulated in 2007 and 2008 but without any evaluation of the consequent influences. The other one was on November 09, 2006 – "The amount of '*JieJin*' surges today, beware of the risk of selling off" which only gives a brief introduction of the situation of "*JieJin*" for five specific companies, but without referring to any broader impact on the market. In another section on the specific topic of "*JieJin*" from the web portal (http://finance.sina.com.cn/focus/dafeixiaofei/4.shtml accessed on June 15, 2009) shows that there was no information posted between March 21, 2007 and February 05, 2008. On the government Chinese Securities Regulatory Commission (CSRC)'s website, the section on the SSSR had not been updated since April 20, 2007 (http://www.csrc.gov.cn/n575458/n4238522/n4238662/index.html accessed on June 15, 2009).

It seems that those dominate media outlets silenced the issue of "*JieJin*" until the market reached its lowest point in early 2008[10]. The possibility of massive media censorship of this is not farfetched. It is, based on well established research external to China (e.g. Esarey 2006), actually a daily routine of China's public media whenever the government wants a certain agenda to be hidden from the public. The common knowledge would point to the ultimate beneficiary of this kind of manipulation in the markets. As Wang (2005, p. 180) predicted in his PhD thesis on the SSSR that "those shareholders of non-tradable shares would sell those shares in high, and buy back in low to maintain the control". Certainly, the biggest winner was the state – the ultimate shareholder of all those non-tradable shares who could cash out the windfall under such an 'ideal' market condition.

The consequence of this kind of information asymmetry is extremely harmful to those smaller retail investors, especially domestic individuals who are the major market participants. Wan (2005) shows that retail investors – individuals investing their own funds as opposed to institutional investors, occupied 99.52% of total A-share accounts in China by the end of 2004. Those who haven't been fully informed about the potential impacts of the "*JieJin*" on the market would hold the shares with unrealistic optimism, being misled by the media when the market started to fall. A

[10] The market went down from 6092 points on 16 October 2007 to about 2000 points by February 2008 (Shanghai Stock Exchange, www.sse.com.cn).

survey conducted by Phoenix News Service – a Hong Kong-based broadcasting company shows that 88.6% of investors had a loss from A-share trading in 2008, among which 48% of people lost over 50% of their capital (Phoenix News 2008). It is suggested that a balance of power and transparent information disclosure is crucial for people's suspicion to be dismissed, for example, a disclosure of the capital gains that the government has secured by selling off non-tradable shares, and the use of the fund. The information, unfortunately, is not accessible.

What is even worse in light of the long-term development of capital markets is that the old problem of dominant state ownership in listed companies won't be resolved by this reform because, no matter what investors expect of the results of this reform, the state is still the dominant shareholder in those listed companies. This has been stipulated clearly in another document released by the CSRC on August 23, 2005 stating that,

> The Share Reform is designed to float the former non-tradable shares rather than for the purpose of unloading state-owned shares through the open market…The controlling shareholder of the state-controlled listed company shall determine a reasonable minimum stake in the listed company under its control in light of the national layout and structural adjustment strategy with respect to the public sector economy. State capital shall be persistently maintained to the extent that it holds dominant control and acts as the leading force in sectors that are vital to the national economy and public welfare, as well as in the state-controlled listed companies that are fundamental and the pillar for the national economy. Where necessary, the state-owned shareholders may increase its stake in such listed companies through buying shares in the open market. (CSRC 2005)

Therefore, if the state intends to maintain the control, the SSSR would be meaningless in terms of the acclaimed purpose – change the ownership structure of Chinese listed companies through converting the non-tradable shares into tradable ones. Instead, the ultimate outcome would be that those shares are 'freed' in name but still controlled by the most powerful agent with the costs endured by a larger amount of retail-investors - investors who have been the victims of information asymmetry and hence the market manipulation.

From the above, the share price of Chinese listed companies renders really limited information about the performance of the companies and hence the real economy, since the movement of the markets have been thoroughly intervened by the state. The FVA, however, requests financial statement preparers to quote this manipulated observable market price as 'fair value' and carry the resulting value changes into the income statement. This is highly problematic because those market prices are indeed not a fair indication of a company's financial position as the theory of fair value suggests. This has suggested no perceived benefits to users of the financial reports. As a result, it would be really challenging to establish a functioning FVA in China given the circumstance.

4. CONCLUSION

The globalisation of the accounting discipline has been promoted through global accounting regulation, namely, International Financial Reporting Standards. China's commitment to this collective effort has led to a comprehensive application of FVA to its accounting practices which had been absent in the past. This paper considers the implementation of the FVA as problematic in China. Given that the majority of Chinese listed companies cross-hold other companies' shares, the adoption of FVA has forced Chinese listed companies to disclose the value change of those cross-holding shares by referring to the observable market share prices. The change in the value of these financial assets also needs to be incorporated into the reported profits under the standard. As this paper shows, that those market share prices are not 'fair values' of companies' financial position, rather, they project only the distorted share price movements in Chinese capital markets which have been caused by the inappropriate intervention of the predominant player – the state government. Given the infeasibility of the new standards caused by the unique contextual differences in Chinese society and institutions, it is important to consider why China has made such a change and what forces have driven this move.

By exploring this process through the lens of neoliberal theories, this paper argues that FVA is imbued with neoliberal assumptions. In fact it is an artefact of neoliberalism. There are strong links pointing out the influence of neoliberalism over this accounting change. The rapid progress of the FVA has been a result of the rising importance of financial instruments due to the world-wide emergence of a strong finance sector, and the shift of economies into high-tech and information-orientated sectors. These are all major features of the neoliberalised global economy. Also a fundamental belief in the benefits of a free market mechanism is consistent with the neoliberal philosophy.

An understanding of neoliberal theory, however, challenges the very purpose of the neoliberal movements that have shaped many societies across the world over the past decades. Rather than generating universal good to majorities by pursuing a competitive environment and hence efficiency and productivity, neoliberal market which provides more freedom to international corporations and their capital. This creates a new institutional arrangement in favour of the prosperities of the few economic and/or political elites. Hence FVA is, as part of the broad picture, a device through which the market can be signposted and represented as the appropriate allocative forum and that the state should be relegated to 'referee' status.

The investigation of this paper into Chinese capital markets explores how an account technique can be the handmaiden of neoliberalism, pushing forward an image of a market that is belies its underlying architecture. We have demonstrated that the public interest has not been served by the volatility brought into Chinese capital markets due to the reporting earnings under FVA ; and that there are problems with the claim that financial reporting based on 'fair values' are in fact derived from active and free markets. We have shown that these markets have been manufactured and tempered by the SSSR and the accompanying regulatory intervention from the Chinese government. The purpose of this exploration is to consider the broader purpose of FVA in China, and to critique the consequences of neoliberalised public policies that

redefine the global and domestic order leading to a restoration/reconstitution of ruling class power. The resultant economic unrest and crises of capitalism caused by neoliberalism, as Harvey (2005, p. 153) reminds, "[i]t is ordinary people who suffer, starve, and even die…rather than the upper classes." Nowhere is this more apparent than in China.

Appendix:

Table1. (based on Zhang (2009)'s research)

Up to	No. of "*JieJin*" Shares (billion)	% of total A-shares	Market capitalisation (in billion Yuan)	% of total market capitalisation
31-12-2007	128.50	8.06 %	2,244.20	7.29 %
31-12-2008	162.07	9.18 %	2,118.31	17.12 %
31-12-2009	685.09	37.81 %	3,458.71	27.16 %
31-12-2010	357.69	19.54 %	3,763.47	29.30 %

Table 2. (Shanghai Stock Exchange, www. sse. com. cn)

Year	Market Capitalisation (billion RMB)	Circulated Share Value (billion RMB)	transaction Number (million)	Volume (billion shares)	Turnover (billion RMB)
1991	0.00	0.00	0.12	0.12	0.81
1992	0.00	0.00	1.99	1.78	24.90
1993	0.00	0.00	24.43	14.74	234.05
1994	0.00	0.00	48.99	65.68	573.51
1995	0.00	0.00	44.36	51.28	310.35
1996	533.56	126.66	184.74	110.12	911.48
1997	0.00	0.00	158.01	121.57	1,376.32
1998	0.00	0.00	156.71	112.40	1,235.27
1999	1,458.05	424.97	179.71	156.04	1,696.58
2000	2,693.09	848.13	304.92	243.77	3,137.39
2001	2,759.06	838.21	209.75	182.00	2,270.94
2002	2,536.37	746.73	175.57	178.11	1,695.91
2003	2,980.49	820.11	206.61	269.28	2,082.41
2004	2,601.43	735.01	260.16	360.77	2,647.06
2005	2,309.61	675.46	210.14	398.66	1,924.02
2006	7,161.24	1,642.83	447.26	1,028.39	5,781.66
2007	26,983.89	6,453.22	1,617.33	2,432.54	30,543.43
2008	9,725.19	3,230.59	1,278.84	1,631.16	18,043.00

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