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THE FORMING PROCESS OF PEOPLE'S REPUBLIC OF CHINA INTERNATIONAL ACCOUNTING STANDARDS

Yasemin Kaplan, Hülya Boydaş Hazar

Institute of Graduate Studies / Istanbul Aydin University, Turkey

Department of Business / Business Administration Program / Istanbul Aydin University, Turkey

E-mail: yaseminkucukkaplan@hotmail.com

Abstract: **In order to make businesses and to be successful in a global environment, information should be analyzed in a common language and instantly transformed to investment. In the process of using information, it is very important to harmonize accounting standards in interpreting financial statements of individuals and institutions. Since multinational companies doing business in different countries, they face different accounting practices which changing country to country. There are various reasons that affect the financial reporting faced by multinational enterprises such as economic structure, political conditions, tax laws, applicable accounting standards, different accounting principles in different currencies, transfer prices, inflation, qualified manpower and culture. These factors change the results of financial reporting.**

In response to globalization in today's economy, accounting professionals from all over the world have worked carefully to develop a common accounting language worldwide for decades In this study, the history of the accounting systems of the People's Republic of China, which has especially rapidly increased its status to developed economies due to the rapid economic growth in the last two decades. Development in the accounting system, its momentum showing international arena and the international standards will be evaluated and transparent information will be presented to the individuals and institutions that will use the information.

Keywords: **Accounting, China, Development, Finance, History, International Financial Reporting Standards.**

I. INTRODUCTION

The accounting system is formed according to specific rules for each country. For example, the structure of the state, the cultural structure of people, the cultural structure of commercial activities, economic values, the economic structure of the country, the legal structure of the country are the factors that shape the development of accounting systems. While the development of accounting at the beginning of history was largely driven by state and economic developments, the development of this system is now accepted as global. It is observed that the cultures of the country show similar characteristics, and especially the internationally developed companies and developing technology have developed and directed accounting systems. While the data obtained in the creation of accounting systems are transferred to the information users, the information about the commercial activities must be accurate, reliable, meaningful, appropriate and comparable. Because accounting systems are especially important for businesses. Therefore, the effect of globalization results becoming international and technology's effect on the internationalization of businesses by gaining importance at the international level again, the accounting system should emphasize the need to standardize the operating results (Deloitte, 2006).

In response to globalization in today's economy, accounting professionals from all over the world have worked carefully to develop a common accounting language worldwide for decades. Therefore, International Financial Reporting Standards

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(IFRS) were born under such efforts. Due to the high degree of transparency and comparability of financial statements, IFRS is considered as an accounting system aimed at the efficient functioning of the capital market and the domestic market. (European Communities, 2010). Although it does not fully comply with the International Financial Reporting Standards, the new Chinese Accounting Standards adopt the same principles contained in IFRS and therefore it is considered to be substantially combined with IFRS (The Institute of Chartered Accountants in Scotland, 2010). Integration in account standards in China represents a bigger leap than traditional accounting system. The set of generally accepted accounting standards used by the People's Republic of China is called the China Generally Accepted Accounting Standards (PRC GAAP) and represents the government's efforts to greatly improve the overall quality of accounting and financial reporting in China. The Chinese government has also been actively involved in the process of converting Chinese accounting standards with IFRS.

The importance of this study is to be able to give an information about following:

- An overview of People's Republic of China's accounting history,
- Development process of accounting system of People's Republic of China's accounting history,
- The current use of international standards by People's Republic of China,
- To help investors in the global economy more transparent and understandable information.

II. LITERATURE REVIEW AND FINDINGS

A. Historical development of accounting system of People's Republic of China

Chinese unilateral input-output recording method was used in state accounting in Zhou time (1066 BD-771 BC). Among other methods, this method remained in force until the middle of the nineteenth century. The method has three main features. 'Ru' meaning input and 'Chu' meaning output are used as registration symbols. The use of Chinese characters, the classification of accounts in the daily ledger (Cao Liu) and the large ledger (Zong Qing) led to checking accounts in three columns. (Received as current - Payments = Balance) (Solas and Ayhan, 2007). Later, these three column methods were developed as four columns. The application of the quadruplet column coincides with the period of Tang dynasty (A.D. 618 - A.D. 907) The main of the four columns is based on: (Balance Sheet Period) + Current Delivery - Payments = Balance (Gao and Schachler, 2003). During the Ming dynasty (AD 1368 - AD 1644), the unilateral book recording system was insufficient due to the increase in commercial activity. Because it is difficult to follow this path in a structure that numbers and transactions are being complicated (Solas and Ayhan, 2007). The three-stage book recording method emerged approximately in the middle of the fifteenth century according to the need. This method led to the development of a four-step method in the late period of the fifteenth century. This is the first double-sided book recording system in China. The double-sided system was not widely used until the nineteenth century. Before the nineteenth century, the Chinese accounting system was mainly based on account books such as *caoliu*- journal ledger, *xiliu*-general ledger and *zonqing*-large ledger. Transactions follow the steps of registering to caoliu (daily ledger), then transfer to xiliu (journal ledger) and eventually registering to zongqing (large ledger). And the last task is the preparation of the accounting report (Auyeung and Ivory, 2003).

As an important milestone in Chinese accounting development, four-stage book recording system used in the eighteenth century. This method is also known as *tiandi panzhang*, the earth and sky method. It has a wider account classification and records associated with general accounts are better integrated. The reason for this is to establish a system that can deal with larger volume and more complex commercial transactions (Solas and Ayhan, 2007).

Chinese accounting showed its existence at a time when agricultural items were abundant and commercial affairs and handcrafts were growing. The book record system played an important role in determining commercial profit as an effective memory aid. Since the calculation of profit and loss is on a cash basis, the number of prepayments and growth is not important in the context of accountability. There is no clear distinction between capital and investment spending. There is also no special interest in measuring profit. The basic forms of commercial organizations based on partnerships which the family owned, are seen for that time. Partnership companies are not seen yet. It can be said that economic growth in China's nineteenth century provided only a quantitative expansion rather than qualitative progress requiring capital intensive investments. Moreover, there was not accounting practice that would create the idea of calculating

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capital expenditures and friction, and such an attraction did not occur. This period carries the traces of an internal Chinese accounting and bookkeeping methods. This meets the complex nature of pre-industrial commercial life, but for further processing, another shell-change process is needed (Auyeung and Ivory, 2003). When we look at the Chinese accounting history, it has emerged that the important factor was not the separation as assets, liabilities, equity or earnings; but was to observe the balance of cash flows from inside to outside and from outside to inside (Solas and Ayhan, 2007).

B. Importance of China ministry of finance in system development

The People's Republic of China Ministry of Finance (MOF) is the national executive agency of the central of China government, which manages macro-economic policies and the annual national budget. It also deals with fiscal policy, economic regulations and government expenditures. The ministry also records and publishes annual macro-economic data on the Chinese economy including economic growth rates, central government debt and borrowing statistics, and many other indicators related to the Chinese economy. The Chinese Ministry of Finance's duty is smaller than its counterparts in many other countries (The State Council the People’s Republic of China, 2020).

With the participation of China in the World Trade Organization (WTO), Chinese enterprises and commercial activities in China are increasing rapidly. China clearly understands that a strong financial reporting system plays a key role in the economic development process. The Ministry of Finance of China, which has the responsibility to regulate accounting matters in China, has set the goals of increasing investors' trust in financial information, increasing the transparency of financial reporting and complying with International Financial Reporting Standards (IFRS). With the goal of developing Chinese accounting standards, the Chinese Ministry of Finance has made significant progress and it is considered as an important factor in meeting the needs required in the field of accounting.

C. Development process of Chinese accounting and accounting organization

When the People's Republic of China was founded in 1949 under the political influence of the Soviet Union, the government has established a planned economy. While the government restructured the economy, many government-owned businesses have been privatized. Even today, most part of the Chinese economy still consists of state-owned enterprises. Many initiatives are supported by the government and the Chinese government has undergone a series of reforms aimed at transforming the once-controlled government economy into a more open market economy. By means of the internal process over thirty years, the Chinese leadership has been able to move from a centrally planned economy to the second largest world economy (Xue and Zan, 2011). Although the Chinese political system is still socialist, the economic system changes from a planned economy to a market economy.

China's accounting system has improved significantly since the 1978 economic reforms started by Deng Xiao Ping. There was not a special accounting system for China before 1978. Due to this historical excuse, China has adopted a similar accounting model used in the Soviet Union and this is quite different from systems developed in the west (Lehmanbrown, 2016). The Chinese economy started to liberalize in 1979 and has experienced remarkable growth since then. The new accounting system is based on international accounting standards and the accounting system has been experiencing better changes since its implementation. The Chinese Generally Accepted Accounting Standards are based on the Chinese Accounting Law, the highest authority in Chinese accounting. The law sets out general accounting principles for all businesses and also empowers the China Ministry of Finance to manage accounting affairs and establish uniform accounting arrangements and systems. According to the accounting law, the finance ministry has issued several accounting regulations that apply to businesses in different categories (Zainiguli ve Haftacı, 2016).

D. Formation process of international accounting standards in People’s Republic of China

International harmonization is defined as the process of synergizing and reconciling various systems (Samuels and Piper, 1985). International accounting harmonization is a concept resulting from the need to reduce the differences between financial reporting practices between countries, to compare financial reporting and to develop international accounting standards accepted in all countries (Hoyle et all., 2004). Harmonization helps investors to make the right decision. Proponents of compliance argue that comparison in financial reporting is an advantage for investors because it facilitates the determination of the potential value of investments and reduces the risk of international diversification. In addition, as a result of harmonization, companies will be able to enter all capital markets in the world with financial reporting standards. Internationally accepted accounting standards will reduce costs in the preparation of consolidated financial reports which will be valid all over the world and it will be easier to audit these reports (Fritz and Lammle 2003).

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Studies on international accounting standards are a major problem in Asian countries, which have become more important for international trade and globalization investments (Charias & Radianto 2001). Especially People's Republic of China, which is growing day by day and accepted as one of the most important economies of the world, increases the attractiveness of the region. After the establishment of the Shanghai Stock Exchange (SSE) and Shenzhen Stock Exchange (SZSE) in China in the early 90s, the accounting system has fundamentally changed. The Shanghai stock exchange was established on November 26, 1990 in Shanghai, China. This exchange, which has a market value of 3.5 trillion dollars as of 2015, is the second largest stock exchange in Asia and the fifth largest stock exchange in the world. The Shenzhen stock exchange was established, right after, on December 1, 1990. As of 2015, the Shenzhen stock exchange, which has a market value of 2.2 trillion dollars, was established in the Shenzhen region of China. It is considered as the second largest stock exchange in China, as it is among the fourth largest stock exchange in Asia and the eighth largest exchange in the world. In response to the development of exchanges, the Chinese government published an accounting regulation for companies experimentally listed in 1992. After this arrangement, China separated from the traditional Soviet accounting model and included many accounting practices that reflect the International Accounting Standards (IAS) to its own accounting from the west (Chen et al. 2002). In addition, a rework was made to redefine earnings in accordance with International Accounting Standards. Despite these regulations, significant differences between these two systems could not be eliminated, and the new Experimental Listed Companies Regulation was published in 1998 to eliminate discrepancies between these standards. Using the International Financial Reporting Standards model, 16 new Chinese Accounting Standards have been published by the Chinese Ministry of Finance. These standards are valid for companies traded on the stock exchange as of January 1, 2007.

In addition to the development of accounting standards, China's Ministry of Finance announced the Accounting System for Small Businesses (ASSBE) at the end of 2000. As of January 1, 2001, all joint stock and limited companies had to follow ASSBE. The implementation of ASSBE has significantly improved comparability between China and International accounting practices. As of being valid from January 1, 2002, foreign investments enterprises in China are required to apply ASSBE. In March 2003, the Chinese Ministry of Finance further expanded the applicability of ASSBE to apply to all establishments that established (except small businesses and financial institutions) on or after 1 January 2003. In the long term, the China Ministry of Finance plans to apply ASSBE to all major companies and aims to combine different accounting practices adopted by different industries and different businesses to improve comparability of medium-sized businesses and financial information, including state-owned enterprises. In addition, by taking into account the specific characteristics of financial institutions and small businesses, China Ministry of Finance has published a new Accounting System (ASFI) for Financial Institutions and a new Accounting System (ASSBE) for Small Businesses. ASFI is valid for all financial institutions and foreign financial institutions listed as from January 1, 2002. As of January 1, 2004, the applicability of ASFI has been extended to security companies which are without foreign capital investments. ASSBE will be applied to qualified small businesses, as being valid from 1 January 2005.

The Chinese government has also been actively involved in the process of converting Chinese accounting standards with IFRS. On February 15, 2006, the Chinese Ministry of Finance published a new set of Chinese accounting standards for businesses, as being valid on January 1, 2007. The adoption of these new standards seems to be an important step for economic development in China and increases China's position in the world's increasingly integrated capital markets (Rutledge, Karim and Gong, 2015). The new accounting standards are massively the New China Generally Accepted Accounting Standards consisting of a basic standard and thirty-eight specific practices for specific topics. While China Accounting Standards Committee (CASC) is developing these new standards, included the International Accounting Standards Board (IASB) to verify the extent to which the New China Generally Accepted Accounting Standards converged with IFRS. And the joint statement published by CASC and IASB on November 8, 2005 stated that the new standards converge with IFRS (KPMG, 2011). However, there are concerns that the merging of accounting standards does not mean the merging of accounting practices. Combining accounting standards in this way may not achieve the goal of increasing comparability and transparency. In December 2012, the Securities and Exchange Commission (SEC) targeted the Chinese affiliates of four major accounting companies (Pricewaterhousecoopers, KPMG, Deloitte and Earnst&Young) and some Chinese companies accused of not delivering documents required to investigate fraud allegations. SEC advocates that companies that audit companies traded in the U.S. must comply with U.S. legal standards and Sarbanes-Oxley Law advocates that upon the request of the 3 SEC, foreign audit firms require the submission of documents. Whether Chinese affiliates will continue to audit companies traded in the U.S. depends on the decision of administrative law, however, accounting misapplications/illegal practices may even occur in advanced accounting standards (Yang, 2013).

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In 1993, with funds from the World Bank, the China Ministry of Finance has started a project to develop about 30 accounting standards that are suitable for China's emerging socialist market economy and aim to harmonize accounting and financial reporting practices in China with international practices. Deloitte Touche Tohmatsu worked as a consultant in this project. Draft regulations on 30 standards were published between 1994 and 1996. In 2000, Deloitte Touche Tohmatsu (DTT) was reassigned as the consultant of the second phase of the project to develop about 17 additional standards as a series of industry-specific standards related to the IASC (International Accounting Standards Committee)'s (now known as IASD-International Accounting Standards Board) topics. Until today, 16 standards have been set as the final standard for "Accounting Standards", while others are being in development phase.

Table 1: CHINEESE ACCOUNTING STANDARDS

NO	ACCOUNTING STANDARD	VALIDITY DATE	APPLICABILITY
1	Disclosure of Relations and Transactions with Related Parties (Minor revision made in 2001)	January 1, 1997	Listed companies on the stock exchange
2	Cash Flow Statements	January 1, 2001	All companies
3	Events Occurring the Balance Sheet Date (Revision 2003)	July 1, 2003	Companies that adopt ASBE
4	Debt Restructuring (Significantly revised in 2001)	January 1, 2001	All companies
5	Income	January 1, 1999	Listed on the stock exchange companies
6	Investments (Minor revision made in 2001)	January 1, 2001	Joint Stock Companies (only before businesses listed before January 1, 2001)
7	Construction Contracts	January 1, 1999	Listed on the stock exchange companies
8	Changes in Accounting Policies and Estimates and Corrections of Accounting Errors (Minor revision made in 2001)	January 1, 2001	All companies (only before businesses listed before January 1, 2001)
9	Non-Monetary Transactions (Significantly revised in 2001)	January 1, 2001	All companies
10	Extraordinary Reserves	July 1, 2000	All companies
11	Intangible Assets	January 1, 2001	Joint Stock Companies
12	Loan Costs	January 1, 2001	All companies
13	Leases	January 1, 2001	All companies
14	Interim Financial Reporting	January 1, 2002	Listed on the stock exchange companies
15	Stocks	January 1, 2002	Companies that adopt ASBE
16	Fixed Assets	January 1, 2002	Companies that adopt ASBE

Source: Deloitte Touche Tohmatsu (2005)

III. CONCLUSION

In this article, detailed information is given about the historical development of accounting standards in China and the phases it has undergone until it became international. We can summarize the reflection of the quality and profitability of the merger in international standards as follows. The issue of financial reporting quality concerns many parties, both within China and in the global arena. In particular it concerns the following three groups:

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The first group includes business owners and entrepreneurs looking for expansion opportunities in the Chinese market. Globalization is not a new phenomenon; rather, it is a sign that shows the business world today. Globalization affects the economic, social, political and environmental aspect of our daily life. The current wave of globalization is unique due to the involvement of a wide geographic area, complexity and different level of communication, its relationship and the participation of many countries among developing countries (Buang, Lim and Samimi, 2011). As a result of globalization and international cooperation, more and more companies in the United States are building close ties with China which is one of the fastest growing economies. Many American companies have opened their franchises in China. American brand names quickly spread to the Chinese market and some brands have become icons for fashion leaders and technology gurus and have been eagerly followed by the new generation of Chinese people. When companies analyze a market with expansion opportunities, they can analyze the financial statements of their potential competitors to gain market information. If financial reporting is in poor quality, companies cannot obtain valuable information.

The second group includes foreign investors investing in stocks issued by Chinese companies and traded on foreign exchanges. Due to the many benefits associated with cross-listing, many companies prefer to attract foreign capital by trading their shares in foreign exchanges. In 2007 alone, thirty-one Chinese companies completed the US charts. This figure corresponds to a double increase compared to 2005 and 2006. Listing stocks in foreign currency becomes a more popular place for companies to attract capital. Some of the advantages associated with overseas listing firstly includes improved cash transparency. Trading on a more cashable market can increase the cashable of a stock. From another point of view, trading in different time periods and currencies provides more cashable to companies. Cross-listing can also attract a wider audience and thus increase the company's ability to raise capital. Also strengthens investor protection in foreign countries. Registration to the US stock exchange acts as a mechanism that voluntarily devotes the firm to a higher standard of corporate governance and investor protection, as exemplified by the 2002 Sarbanes-Oxley law. While making investment decisions, individual investors or portfolio managers will analyze the financial statements to learn about the company's profitability, working conditions, convertibility to cash and debt structure etc. Investors need high-quality information from the financial statements to be able to make high-quality analysis for investment decisions.

The third group is domestic investors in China. Due to the unique stock market structure in China, companies that issue A shares prepare their financial statements follow the China International Financial Reporting Standards, and the companies that issue B shares follow IFRS. If combining Chinese accounting standards with IFRS means improving the quality of financial reporting, the merge will undoubtedly increase the confidence of the investor investing in A stock.

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