

Challenges in Applying Global Accounting Standards in China

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The views expressed in this presentation are those of the presenter, not necessarily those of the IASB or IFRS Foundation.

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Background

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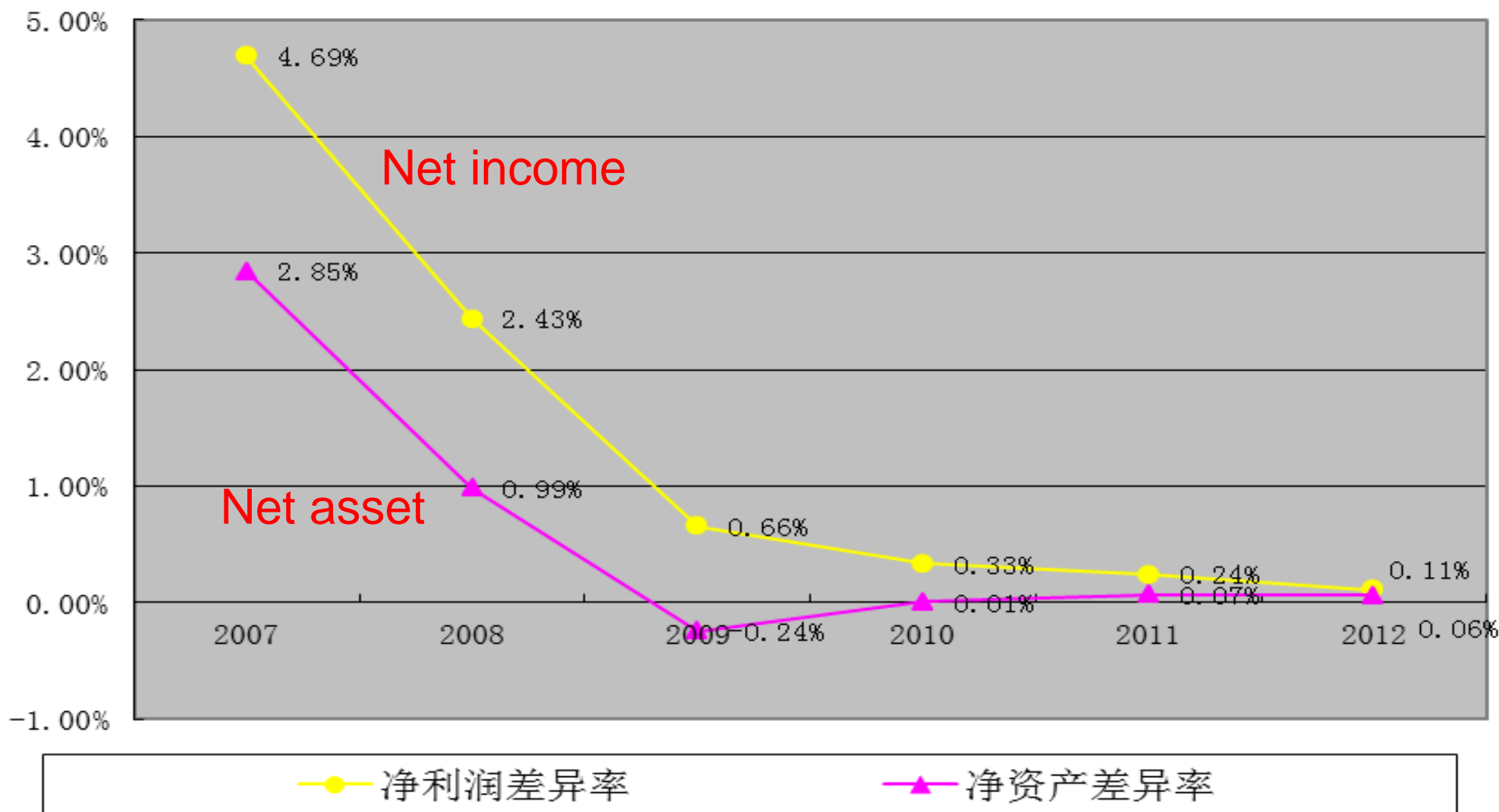
Two major reforms from early 1990s

- At the beginning of 1992, the Chinese government decided to transform the economic system into a market oriented one, based on Deng Xiaoping's call during his historical visit to south China.
- Later that year, China replaced the Soviet Union style uniform accounting systems by a combination of accounting standards and accounting systems.
- From 2006, China abolished the two tiers system, and replaced it by a single set of accounting standards significantly converged with IFRSs.

Closeness of Chinese GAAP with IFRSs: based on AH companies' annual report

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2007-2012 H股-A股净资产净利润差异率比较



Challenge 1: how to maintain continuous and full convergence with IFRSs

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How to maintain continuous and full convergence with IFRSs

- Chinese accounting standards are substantially converged with IFRSs.
- Because of this, EU has recognized these standards as equivalent standards.
- Similarly, Hong Kong has signed agreement with mainland, and allowed mainland Chinese companies to use either IFRSs or the Chinese standards.
- To keep the basis of equivalence status, China has been exerting every effort to ensure continuous and full convergence with IFRSs through various ways.

How to maintain continuous and full convergence with IFRSs

- However, from 2011, IASB have been doing more maintenance work through minor amendments or interpretations.
- These will inevitably result in GAAP differences between Chinese standards and IFRSs, even though these differences are mostly minor, or due to time lags.
- As a result, it will become a big challenge for China to maintain continuous and full convergence with IFRSs.

Challenge 2: how to exert adequate influence to IASB's standard setting process

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How to exert adequate influence to IASB's standard setting process

- China is now an important part of IASB's standard setting structure through its membership in:
 - Board of Trustees;
 - IASB;
 - Interpretation Council;
 - ASAF;
 - Advisory Council;
 - Working groups.
- China is leading IASB's Emerging Economies Group.
- China is also one of the founding and key members of Asia Oceania Standard Setters Group.

How to exert adequate influence to IASB's standard setting process

- In addition, China has become more active in IASB's standard setting process through:
 - submitting written comments;
 - organizing or participating in IASB's outreach meetings;
 - sending delegations to IASB office to express views.
- As a result, IASB has solved many issues from China, such as disclosure of related party transactions, asset revaluation, etc.

How to exert adequate influence to IASB's standard setting process

- Nevertheless, since China is such a vast and unique economy, it may have accounting issues other countries do not have.
- To ensure continuous and full convergence, and possibly towards full adoption, China has to be more active, and exert adequate influence to IASB's standard setting process.

Challenge 3: how to ensure consistent application of principle based standards

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How to ensure consistent application of principle based standards

- IFRSs are principles-based.
- This means implementation of IFRSs rely significantly on judgments and estimates by preparers and auditors.
- Current Chinese standards leave less discretion in judgments and estimates because the standards:
 - choose cost rather than fair value as default measurement basis for investment property, biological assets;
 - require pooling of interests for business combination under common control;
 - do not allow reversal of some impairments.

How to ensure consistent application of principle based standards

- Nevertheless, comparing to traditional accounting system, current Chinese standards give preparers and auditors wider room for judgments and estimates.
- This might result in earnings management.
- Therefore, it becomes big challenge to the standards setter and regulators on how to ensure consistent application of those standards.

Challenge 4: how to take next steps towards full adoption

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How to take next steps towards full adoption

- China was more advantageous than most other major countries when it published converged standards in 2006.
- Now, among G20:
 - $\frac{3}{4}$ have become full adopters of IFRSs;
 - US, Japan, India have not fully adopted IFRSs, but they have allowed different companies to publish IFRSs based financial statements in their local markets.

How to take next step towards full adoption

- Would it be beneficial to China to allow some companies to use full IFRSs in local market?
- What are those companies?
- How to make such kind of options, including how to remove legal barriers to do so?
- Would market accept such kind of options? Or whether this would result in significant negative reaction from the market?
- All these are very challenging issues.

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Challenge 5: how to establish appropriate multinational regulatory mechanism

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How to establish appropriate multinational regulatory mechanism

- Ever since China resumed its capital market in early 1990s, it has been paying great attention to enforcement.
- As a result, although there have been some accounting fraud cases from time to time, these cases are not big enough to create significant negative impact on the market.
- Similarly, right from the beginning of rebuilding its capital market, China has allowed companies to list in Hong Kong, US and other international markets.

How to establish appropriate multinational regulatory mechanism

- There has been no major accounting fraud case among those companies. But recently there are some problems among local and foreign regulators related to financial information of those companies.
- It appears a big challenge on how to establish appropriate multinational regulatory mechanism, and to find a win-win solution to such problems.

Concluding remarks

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Concluding remarks

- Chinese accounting standards are substantially converged with IFRSs.
- On this basis, both EU and Hong Kong have recognized Chinese standards, and accepted Chinese GAAP based financial statements.
- Looking forward, China will face various challenges in applying global accounting standards, including:
 - how to maintain continuous and full convergence with IFRSs;
 - how to exert adequate influence to IASB's standard setting process;
 - how to ensure consistent application of principle based standards;

Concluding remarks

- how to take next steps towards full adoption; and
 - how to establish appropriate multinational regulatory mechanism.
- It will take time and need wisdom to find solutions for these problems.
 - But I am optimistic because more than 30 years' history of Chinese reform and development proves:
 - If you look forward, you might see lots of troubles.
 - If you look back, you might find the developments are so fast and encouraging.

