Challenges to the IFRS Adoption in China

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ABSTRACT
The objective of this paper is to clarify the challenges to the adoption of International Financial Reporting Standards (IFRS) in China. By adopting the case study approach and using data collected from various sources, this paper clarified challenges to the direct adoption of IFRS in China, including the endorsement process, the interpretations of IFRS by the Ministry of Finance (MOF) and Chinese accounting professionals, the costs of IFRS implementation, the translation of IFRS into Mandarin Chinese and the IFRS-related training and education. The unique Chinese institutions would mainly pose these challenges. By unraveling the incompatibility between the direct adoption of IFRS and Chinese-specific institutional framework of financial reporting, this paper argues that even IFRS are adopted in all countries; the interpretations and applications of IFRS may be diversified across countries. This suggests that in order to achieve the de facto global convergence of financial reporting, the discussions should be extended from simple accounting issues to a more holistic perspective, including the institutional diversity surrounding the accounting systems in individual countries.

Keywords: International Financial Reporting Standards (IFRS), institutional complementarity

INTRODUCTION
The International Accounting Standards Board (IASB) has been developing the International Financial Reporting Standards (IFRS) and facilitating the international use of IFRS. The promotion of convergence with or adoption of IFRS has been largely supported by the growth of multinational enterprises and the increasing globalization of capital markets. Numerous researches indicated that the multinational enterprises would benefit from the adoption of IFRS. Specifically, international use of IFRS will lower multinational enterprises’ cost of preparing more than one set of accounts and consolidating financial statements under different accounting standards (Chand, 2005; Irvine, 2008; Phan, 2014). Especially, because the multinational accounting firms have necessary knowledge and skills to apply IFRS, they are likely to gain a comparative advantage over local accounting firms in the IFRS adoption (Chand, 2005; Irvine, 2008). Furthermore, the globalization of capital markets requires a single set of global financial standards to reduce the financial reporting costs and improve the comparability of financial information (Nobes and Parker, 2016). With these supports, the use of IFRS has extended rapidly. The IASB’s survey shows that nearly 130 countries have required all or most domestic listed companies and financial institutions in their capital markets to prepare financial statements in accordance with IFRS (as of March 30, 2017).

In spite of the international adoption of IFRS, numerous studies suggested that many countries, especially developing countries, lack necessary infrastructures for the consistent
application of IFRS. Thus, the convergence of accounting standards on *de jure* level may not necessarily lead to convergence *de facto*. For instance, Poudel *et al.* (2014) clarified that the direct adoption of IFRS in Nepal does not necessarily improve the comparability and transparency of financial reporting prepared by Nepalese companies. That is because contextual factors in Nepal, such as widespread corruption, underdeveloped capital market, and a lack of qualified and well-trained accountants, are likely to hinder consistent interpretations and applications of IFRS in Nepal. Mısırlıoğlu *et al.* (2013) illustrated that Turkish listed companies have not applied IFRS consistently or made disclosure in compliance with IFRS requirements in spite of the mandatory IFRS adoption in 2005. Mısırlıoğlu *et al.* (2013) explained that Turkey’s distinct factors, such as the taxation-oriented financial reporting tradition, the lack of efficient enforcement mechanisms, and inadequate management information systems, are likely to pose an impediment to the consistent implementation of IFRS.

In addition to the national-specific factors, such firm-specific factors as firm size and industry are significant elements that determine the effective implementation of IFRS. Guerreiro *et al.* (2008) demonstrated that firm size is a significant variable in determining the preparedness of companies for applying IFRS and showed that larger companies have stronger incentives to improve the quality of financial reporting. Moreover, as IFRS provided managers options on accounting treatments for the same business transactions and economic events, different accounting policy choices under IFRS among enterprises would hinder the comparability of financial information. Stadler and Nobes (2014) illustrated that industry factors would affect IFRS policy choices, partly because enterprises tend to keep policy choices alignment with industry peers. Furthermore, certain accounting issues, such as fair value measurement, would be problematic in certain industries. For example, Muller *et al.* (2008) found that the adoption of IAS 40 and the requirement that all enterprises owning investment properties should display fair values of these assets, whether through recognition or disclosure, have not fully eliminated differences in information asymmetry of European Union (EU) listed companies in the real estate industry. That maybe due to investors’ concerns over the reliability of fair value estimates by managers.

The incompatibility between IFRS and existing national institutional arrangements and the problems related to particular industries or firm size might result in unintended consequences, such as a decrease in the reliability of financial reporting. This may hinder the achievement of intended objectives of IFRS adoption (either mandatory or voluntary), such as improving the comparability and transparency of financial information.

Although numerous studies investigated problems related to the global adoption of IFRS, few studies revealed obstacles to the implementation of IFRS in China. The objective of this paper is to fill this gap and clarify the challenges to the IFRS adoption in China, including the endorsement process, the interpretations of IFRS, the costs of IFRS implementation, the translation of IFRS into Mandarin Chinese, and the IFRS-related training and education.

China is one of a minority of countries that have not required or permitted domestic companies to apply IFRS. The Chinese government requires listed companies in Chinese domestic capital markets and Chinese financial institutions to prepare financial statements in accordance with Chinese accounting standards (CAS). By analyzing the challenges, this paper would provide a rationale for the decision of the accounting standards setter in China, the Ministry of Finance (MOF), concerning convergence with IFRS. This would
helpful for making forecasts about the potential adoption of IFRS in China.

The remainder of this paper is organized as follows. Section two describes the convergence process of CAS with IFRS since 2005. Section three elaborates the research methods of this paper, including the theoretical framework, the case study approach, and the data collection. Section four investigates the main issues that are likely to challenge the IFRS implementation in China. Section five concludes this paper by summarizing the incompatibility between the direct adoption of IFRS\(^1\) and contemporary Chinese-specific institutional arrangements.

THE CONVERGENCE PROCESS OF CAS WITH IFRS

The convergence towards or adoption of IFRS at a global level had put China under strong external pressures to converge its accounting system with IFRS and had triggered accounting reforms in China since 2005. The MOF, at the beginning of 2005, set up a plan to establish 22 new specific accounting standards and to revise the existing basic accounting standard and 16 specific accounting standards until the end of 2005 or the beginning of 2006. The main objective of the reform during 2005 and 2006 was to improve the convergence of CAS with IFRS. Thus, in order to establish a new set of CAS in line with IFRS, the MOF enhanced collaboration with the IASB. The collaboration resulted in a joint statement in November 2005, so-called the “2005 Beijing Joint Statement.” The MOF, in the statement, announced that it would set the convergence with rather than adoption of IFRS as “one of the fundamental goals of” its standard-setting program (CASC and IASB, 2005). The IASB, in turn, took a step back from its initial strong position that convergence meant full adoption of IFRS word for word (Wang, 2006), and recognized that the MOF had the authority to determine the form and ways to converge CAS with IFRS (CASC and IASB, 2005).

Several months after this joint statement, the MOF promulgated a new set of CAS in February 2006, known as the Accounting Standards for Business Enterprises (ASBE). The new set of CAS issued in 2006 was acknowledged by the IASB as having achieved “substantial convergence” with IFRS (IASB, 2006). The “substantial convergence,” as defined by officials within the MOF, meant that the principles of recognition, measurement and reporting in CAS were the same as those in IFRS, although the IFRS have not been incorporated into CAS word for word (Liu, 2006). The MOF and the IASB expected that “substantial convergence” would result in identical financial statements in accordance with either IFRS or CAS (CASC and IASB, 2005). The MOF required all listed companies in China’s domestic capital markets to apply the new set of CAS for both consolidated and non-consolidated financial statements from the beginning of the fiscal year 2007. The MOF has been gradually extending the application of the new set of CAS for both consolidated and non-consolidated financial statements of unlisted large and medium-sized companies (MOF, 2009).

During and after the financial crisis of 2007-2008, the Group of Twenty (G20) addressed accounting as a critical issue for financial stability. It encouraged member countries, including China, to converge their national GAAPs with IFRS or adopt IFRS. With the G20’s endorsement of IFRS as the single set of global financial reporting standards, the IASB further pressured the MOF to directly adopt IFRS in China. For example, since 2011, the current Chairman of the IASB, Hans Hoogervorst, has exerted pressures on the MOF to fully adopt IFRS in China to replace CAS. When visited China in 2011, he gave a speech and stated “there is a lingering suspicion among the broader international financial reporting
community about closeness between IFRS and Chinese accounting standards. In this regard, the term ‘principally in line with IFRS’ does China no favours’ (Hoogervorst, 2011). He further suggested that China should make a decision to “fully adopt IFRS” (Hoogervorst, 2011) as Brazil did.

The MOF, however, had established the “convergence approach” as the strategy to respond to the pressures of the global convergence in financial reporting (see the 2005 Beijing Joint Statement). Under this approach, the MOF continues to develop CAS, while gradually eliminating disparities between CAS and IFRS over time. The MOF has no plans to accept the “direct adoption approach” (either mandatory or voluntary) suggested by the IASB, in which IFRS would replace CAS. Yang Min, former Director General (2010-2015) of the Accounting Regulatory Department within the MOF argued, “the convergence approach is a pragmatic and effective way to meet the needs for establishing and developing accounting standards” (Yang et al., 2011, p. 14) in China, which is a country with specific legal environment, codes of language, and implementation problems.

After a decade of signing the 2005 Beijing Joint Statement, the IFRS Foundation and the MOF held a bilateral meeting, on the occasion of the IFRS Foundation Trustees meeting in Beijing during October 13th to 16th, 2015. The two organizations discussed some options for how to further enhance the cooperation and relationship between them in the future (IASB, 2015b). The bilateral meeting resulted in a Joint Statement, referred to as the “2015 Beijing Joint Statement,” to update the 2005 Beijing Joint Statement. In the updated joint statement, Dai Bohua, Assistant Minister of the MOF, reaffirmed that the goal of the CAS establishment is to achieve full convergence with IFRS. This commitment is consistent with the “G20-endorsed objective of a single set of high quality, global accounting standards” (IASB, 2015a). The IFRS Foundation, in turn, assented to ensure Chinese stakeholders’ full involvement “in the future development of IFRS” (MOF and IFRS Foundation, 2015). Furthermore, the two organizations announced a plan to establish a joint working group “to explore ways and steps to advance the use of IFRS within China and other related issues, especially for those internationally orientated Chinese companies” (MOF and IFRS Foundation, 2015).

Although the 2015 Beijing Joint Statement did not specify the direct adoption of IFRS (either mandatory or voluntary) in China, it raised the likelihood of direct adoption of IFRS (either mandatory or voluntary), at least in the “internationally orientated Chinese companies” (MOF and IFRS Foundation, 2015), after the long-term adherence of the MOF to the convergence approach. Actually, Wang Jun, former Vice Minister of the MOF (2005-2013), suggested this probability in his presentation in the 3rd 2009 IFRS Advisory Council meeting as follows:

Due to factors, such as the law system and culture, at present, it is impossible for Chinese accounting standards to be equivalent with International Financial Reporting Standards word for word. However, we do not disagree that it is attemptable to prepare financial statements of Chinese enterprises, which have listed shares in overseas capital markets, or Chinese large multinational companies, directly in accordance with International Financial Reporting Standards when conditions will have permitted. (Wang, 2009, p.4)

Actually, increasing overseas financing by Chinese enterprises has been a significant impetus for the convergence of CAS with IFRS. At the end of 2016, there were 394 Chinese
companies that have listed shares on the Stock Exchange of Hong Kong. Moreover, Chinese enterprises, in 2016, raised 941,273 million RMB by issuing shares on the Stock Exchange of Hong Kong, while raised 1,990,190 million RMB by issuing shares on Chinese domestic capital markets, namely the Shenzhen Stock Exchange and the Shanghai Stock Exchange. Most Chinese enterprises that have listed shares on the Stock Exchange of Hong Kong prepare two sets of accounts in accordance with CAS and IFRS as adopted by Hong Kong. The MOF acknowledged that converging CAS with IFRS would benefit Chinese enterprises that have raised or intend to raise funds in the global capital market by reducing their financial reporting costs. This was one of the MOF’s motivations to promote the convergence of CAS with IFRS (Miao, 2016).

In addition to overseas financing, Chinese enterprises have been expanding their business activities worldwide. According to the World Bank’s statistics, the foreign direct investment (FDI) of Chinese enterprises in 2015 reached 174.391 billion USD, accounting for about 9% of the global net outflows of FDI, which was 1.866 trillion USD in 2015. Chinese multinational enterprises would have stronger incentives to promote the adoption of IFRS in China, as this would save their costs to consolidate financial statements under different accounting standards.

RESEARCH METHODS

Theoretical Framework

The analyses of this paper are mainly based on the notion of institutional complementarity. Aoki (2001) defined the institutional complementarities as “synchronic interdependencies among institutions” (Aoki, 2001, p.225), such as “political, organizational, and social domains” (Aoki, 2001, p.3), and suggested that “one type of institution rather than another becomes viable in one domain when a fitting institution is present in another domain, and vice versa” (Aoki, 2001, p.225). Applying this notion to accounting, Hail et al. (2010) suggests, “accounting standards are one of many important institutional elements affecting financial reporting practices in a country” (Hail et al., 2010, p.360). Furthermore, as accounting system is likely to be complementary to its surrounding institutional arrangements that vary greatly from country to country, “changing solely the accounting standards” (Hail et al., 2010, p.359) (e.g., adopting IFRS to replace national accounting standards) may “have limited effects and, in some cases, can even have undesirable effects” (Hail et al., 2010, p.359) on financial reporting practices in certain countries.

Case Study Approach

This paper adopts a case study approach. Cooper and Morgan (2008) suggested that the case study approach is useful when the research aims to examine the details of context-dependent, complex and significant events, such as the changes in accounting regulations. Cooper and Morgan (2008) further argued that the case study approach is helpful for understanding the applicability and rationalization of certain accounting regulations in a specific context. Thus, the case study approach is appropriate for this paper. This is because this paper aims to assess the applicability of direct adoption of IFRS (either mandatory or voluntary) in China by discussing the compatibility of IFRS with main elements of the Chinese-specific context (e.g., the political and taxation systems).
Data Collection

The data used in this paper was collected from multiple sources including primary sources and secondary documents. The primary sources mainly include official publications, speeches, and pronouncements of senior officials within the MOF. This is because the MOF is the only authority responsible for establishing Chinese accounting standards and is one of major supervisors of the implementation. The statements of senior officials within the MOF help us explore their rationality and values regarding accounting, and their opinions on the global convergence of financial reporting, especially, the IFRS adoption. We also reviewed documents related to the development and training of Chinese accounting professionals issued by the MOF. The MOF is the major actor to design, establish and improve the development of Chinese accounting professionals (Wang, 2012), which is an essential infrastructure for the consistent and rigorous implementation of accounting standards.

Regarding secondary documents, we scrutinized the MOF’s analytical reports on the implementation of the new set of CAS in order to detect the practical problems and the influence of new accounting standards on financial statements of Chinese listed companies. We also examined the China Securities Regulatory Commission (CSRC)’s regulatory reports in order to understand the problems related to the interpretations and applications of the new set of CAS. The CSRC’s reports also deal with problems regarding auditing of financial statements prepared by Chinese listed companies in accordance with the new set of CAS. As the set of CAS issued in 2006 was acknowledged as having achieved “substantial convergence” with IFRS, it is expected that the implementation problems already identified in the analytical reports of the MOF and the CSRC would still exist during the direct adoption of IFRS (either mandatory or voluntary) in China. Furthermore, the MOF has modified IFRS to accommodate Chinese-specific context when setting CAS. For example, the MOF limited the application of fair value measurement in CAS to reduce the impact of fair value measurement in many areas (Biondi and Zhang, 2007). It is expected that implementation problems identified by the MOF and the CSRC may become more acute if the MOF permits or requires Chinese enterprises to prepare financial reports in accordance with IFRS.

Additionally, the secondary documents include articles and books containing research and analyses of the Chinese accounting system and its surrounding institutions. These documents were written by Chinese and foreign academics, accounting professionals in China, and officials in Chinese regulatory organizations. Other documents include investigation reports by international organizations, such as the World Bank, and foreign organizations, such as the Financial Services Agency in Japan.

By analyzing archived materials, this paper clarifies challenges to the implementation of IFRS in China, including issues concerning the endorsement process, the interpretations of IFRS, the costs of IFRS implementation, the translation of IFRS into Mandarin Chinese, and the IFRS-related training and education.

CHALLENGES TO THE IMPLEMENTATION OF IFRS IN CHINA

Endorsement

According to the Accounting Law (article 7), the National People’s Congress of China has delegated Chinese accounting standards setting authority to the MOF. Since the IASB is
a private standard setter without the power to issue legally binding standards, IFRS as issued by the IASB are not simply applied in each country or region and need to be endorsed by local authoritative agencies. Actually, several countries and regional entities, such as Japan and the EU, have applied endorsement mechanisms for existing IFRS, future amendments of existing IFRS, or the creation of new IFRS.

Endorsement mechanisms had been used as a safeguard against undue foreign influence and to preserve local legislators’ veto rights. For example, the EU had conducted an endorsement mechanism to grant the EU a veto right on IFRS implementation in this region, and ensure its influence in the standards-setting process of the IASB. This had been highlighted by changes of IFRS in response to pressures from the EU during the global financial crisis. One change is allowing reclassification of financial assets out of the “fair value through profit or loss” and “available-for-sale” categories (Camfferman & Zeff, 2015). Thus, it can be expected that if IFRS are adopted in China, the MOF will be likely to apply an endorsement mechanism to create “IFRS as endorsed by the MOF.”

The Chinese-specific institutional arrangements have several prominent features, such as a high weight of the secondary sector in China’s economy, the heavy dependence on bank loans for financing, and the scarcity of qualified accounting professionals. The Chinese reporting system has evolved in concert with these features. For instance, CAS take the historical cost as the principal measurement attribute and restrict the extensive application of fair value. As such, even if the MOF decides to adopt IFRS, it is unlikely that the MOF will permit or require Chinese companies to apply “IFRS as issued by the IASB.” The MOF will be likely to make modifications and exclusions to IFRS to accommodate Chinese interests. For example, although the IASB prohibits the pooling of interests method for business combinations, Yang Min, former Director General of the Accounting Regulatory Department, recognized that this method is necessary for business combinations in China, and stated:

In China, a large number of business combinations happened within the same enterprise groups. These are business combinations under common control, regarding which IFRS have not yet provided clear regulations. Supposing that we accept the “direct adoption” approach, this will result in a gap in the accounting standards, leading to the absence of regulations for such accounting practices. Even if we wait for the IASB to establish a new standard or revise the extant standard for these transactions, we would have to wait for a long time because of the due process, such as planning the project, making research, conducting public consultation, voting, and publishing the standard. This is not conducive to the improvement in accounting practices and financial information of Chinese enterprises. (Yang et al., 2011, p.15)

Additionally, Liu Yuting, former Director General (2002-2010) of the Accounting Regulatory Department, pointed out that CAS excluded the accounting standard for employee benefits, and the accounting standard for financial reporting in hyperinflationary economies. This is because employee benefits are not common in China, and hyperinflation is not expected to occur in an economy under the macroscopical control of the Chinese government (Liu, 2007). Even if the MOF decides to directly adopt IFRS, it will be likely to add certain accounting regulations that are exempt in IFRS, or exclude certain IFRS regulations in the Chinese-specific version of IFRS during an endorsement process. These
deliberate modifications would lead to a national set of IFRS in China. Such a regionalization of IFRS opposes the IASB’s intended goal of facilitating cross-border comparability by establishing a single set of global accounting standards.

Moreover, if the MOF adopts IFRS, the endorsement process will potentially lead to a time lag between the release of standards or interpretations by the IASB and corresponding regulations in “IFRS as endorsed by the MOF.” The time lag may be up to years. For example, the IASB established IFRS 13, and made it effective for annual periods beginning on or after January 1st, 2013. The MOF incorporated IFRS 13 into CAS, and issued the accounting standard for fair value measurement on January 26th, 2014, which was effective for Chinese listed companies since July 1st, 2014. The time lag between the effective dates of the accounting standard for fair value measurement in IFRS and CAS was one and a half years. The time lag between the release of a standard by the IASB and its endorsement by the MOF is likely to hinder the comparability of financial reporting between enterprises in China and firms in other IFRS-adopting countries. This is because the MOF will be unlikely to permit Chinese enterprises to voluntarily apply an issued standard before endorsement while firms in other countries may be applying the standard already.

**Interpretations of IFRS**

Chinese accounting professionals have experienced merely 30 years of development. Moreover, most of them have been accustomed to the rules-based approach during a long period of education and practice under the Chinese accounting system with detailed regulations. Thus, Chinese accounting professionals are considered to lack the necessary education and experience to make consistent interpretations and appropriate judgments under principles-based accounting standards (World Bank, 2009; ICAS, 2010; Chen, 2015). Actually, accountants in Chinese enterprises and auditors in accounting firms have been largely relying on guidance provided by the MOF, such as interpretations (jieshi) and explications (jiangjie). This caused current CAS to provide more specific rules than IFRS do. Such a professional environment fosters precise interpretations and application guidance for a consistent implementation of IFRS in China (Li, 2011).

Chinese regulators, such as the CSRC, have been urging the MOF to provide more precise interpretations and implementation guidance. For example, Li Xiaoxue, former committee member for Discipline Inspection within the CSRC, pointed out that the MOF had not provided adequate interpretations to CAS, and suggested that the MOF should accelerate the development of interpretations. Moreover, Li Xiaoxue suggested that regulators of the Chinese financial sector, such as the CSRC, the China Banking Regulatory Commission (CBRC), and the China Insurance Regulatory Commission (CIRC), should also provide detailed guidance to accounting standards implementation. Li Xiaoxue stated:

> The interpretation mechanism of accounting standards cannot meet the needs of financial reporting preparers and regulators [in China]. The MOF had claimed continuing convergence with IFRS. Thus, it consults regularly with the IASB when developing or modifying the implementation guidance. This process leads to a long period for issuing the implementation guidance, and in some cases, the MOF and the IASB cannot come at definitive conclusions. On the other hand, Chinese capital markets are in an emerging and transitional period. In these markets, new economic events and transactions have been continuously emerging. There is an
urgent need for uniform standards to regulate new economic events and transactions. ... Recent modifications of IFRS, such as accounting standards for the impairment of financial instruments and lease, were characterized as theoretical and had a relatively lack of operability. ... In order to regulate the [accounting standards] implementation and improve the quality and comparability of [financial information], regulators of the financial sector [in China] need to consider how to provide detailed implementation guidance according to the actual situations in [business] entities under their supervision. (Li, 2011, pp.13-14)

Considering the current Chinese institutional factors, such as the lack of accounting professionals who are skilled in making appropriate interpretations and judgments of principles-based accounting standards, and the political pressures from the Chinese capital markets regulator for implementation guidance, the MOF would be likely to provide more precise guidelines, such as bright-line thresholds, and examples, even if it directly adopts IFRS. Moreover, Chinese enterprises will be likely to rely on precise guidelines offered by the MOF in cases where IFRS have gaps or are too vague.

Agoglia et al. (2011) documented the effect of accounting standard precision on financial statement preparers’ judgments. Specifically, their results showed that financial statement preparers were less likely to report aggressively (in Agoglia et al. (2011), preparers are more likely to capitalize the lease) when applying a less precise financial reporting standard (in Agoglia et al. (2011), that is the one with more principles-based lease classification criteria), than when applying a more precise standard (in Agoglia et al. (2011) that is the one with more rules-based lease classification criteria). Given that the MOF is expected to provide more precise guidance than the IASB, accounting professionals in China will be likely to make different judgments from their counterparties in other IFRS-adopting countries, even if China directly adopts IFRS.

Importantly, the MOF has adopted a perspective, focusing on the financial and productive process generated by the whole entity, which leads to a matching-based representation and historical cost valuation. This differs from the IASB’s fair value perspective, focusing on the net worth of the enterprise as the residual to the shareholders and an accounting representation of the market-based value of the firm (Biondi & Zhang, 2007). Thus, the MOF is likely to offer Chinese-specific interpretations and implementation guidelines, which may lead enterprises in China to make different accounting treatments for the same transactions and economic events from IFRS-adopting firms in other countries do. For example, although the MOF adopted the IFRS accounting treatments in current CAS, allowing enterprises to choose cost model or fair value model for the measurement of certain assets (e.g., investment properties and biological assets) after recognition, the MOF “required enterprises to strictly limit the application of fair value measurement during the implementation of accounting standards” (Liu, 2011, p.11). This evidence shows that even if China directly adopts IFRS, the MOF will be likely to provide interpretations and guidelines that are geared towards a local adaptation of IFRS, leading to differences in accounting practices between China and other IFRS-adopting countries.

Additionally, Chinese accounting professionals may face the challenge to interpret IFRS consistently as do counterparties in Anglo-American countries (World Bank, 2009). Specifically, principles-based IFRS contain numerous verbal probability expressions, such as “sufficient certainty,” “reasonable assurance,” and “no longer probable” (Doupnik & Richter, 2004). These uncertainty and probability expressions need to be interpreted
appropriately and consistently to enhance the comparability of financial reporting (Chand et al., 2010). However, several previous studies (e.g., Doupnik & Richter, 2003, 2004; Doupnik & Riccio, 2006; Chand et al., 2010) documented the effects of country-specific factors (e.g., the national culture and accounting professionals’ familiarity with accounting standards in IFRS) on accountants’ interpretations of IFRS. Particularly, Chand et al. (2012) found that Chinese students showed greater conservatism and secrecy than Australian students in assigning probabilities to uncertainty expressions in IFRS. Furthermore, Chand et al. (2012) showed that similar secondary and tertiary education could not mitigate the effects of the national culture on professional judgments of Australian (Anglo-Celtic) students and Chinese Australian students (who were born in China and migrated to Australia to complete their secondary and tertiary education). Even if the MOF adopts IFRS, it would be expected that the unique Chinese national culture, such as long-term orientation and conservative virtues (Hofstede & Bond, 1988), would affect accounting professionals’ interpretations of IFRS. This would lead to different financial reporting between Chinese enterprises and firms in Anglo-American countries.

Cost of IFRS Implementation

The MOF requires Chinese enterprises to prepare both consolidated and non-consolidated financial statements in accordance with the new set of CAS. The MOF considers that a single set of accounting standards for both consolidated and non-consolidated financial statements can avoid maintaining two sets of accounts and reduce enterprises’ cost to prepare financial statements (FSA, 2012). Actually, non-consolidated financial statements are important for Chinese enterprises. First, the CSRC required Chinese listed companies to conduct profit distributions based on non-consolidated financial statements (CSRC, 2008). Second, most Chinese enterprises calculate the taxable income based on the accounting profits reported in the non-consolidated financial statements. Traditionally in China, there has been a close relationship between taxation and accounting, and the calculation of taxable income has been a major purpose of accounting for most Chinese enterprises, especially small and medium-sized ones (Doupnik & Perera, 2012). Moreover, the close link has been specified by the Enterprise Income Tax Law, which defines the financial statements as the basis for calculating taxable income, and requires enterprises to submit financial statements to taxation authorities along with tax returns (article 21, article 54).

Considering that the Enterprise Income Tax Law uses historical cost as tax basis for all assets (article 56), if the MOF permits or requires Chinese enterprises to prepare both consolidated and non-consolidated financial statements in accordance with IFRS (hereinafter, “uniformity approach”), the divergences between accounting regulations and taxation rules would be enlarged, leading to an increase in adjustment costs from accounting profits to taxable income for firms (Dai et al., 2005; Song, 2013). On the other hand, if the MOF permits or requires IFRS only for consolidated financial statements and requires CAS for non-consolidated financial statements (hereinafter, “separation approach”), Chinese enterprises should have to prepare two sets of financial statements. One would be under IFRS mainly for the financial reporting purpose, and the other would be under CAS mainly for taxation purposes and profit distributions. This “separation approach” would require skilled personnels who are competent to prepare financial statements under IFRS and CAS. Considering the increasing complexity of both sets of accounting standards, Chinese firms should need to recruit new employees or re-train
existing employees. The costs to employ or re-train specialized staffs would be a heavy financial burden for companies, especially for small and medium-sized firms. The implementation costs led by the “separation approach” have been demonstrated in Germany (see Hellmann et al., 2010, p.113). As such, either the “uniformity approach” or the “separation approach” would lead to high implementation costs for Chinese enterprises.

Additionally, the adoption of IFRS in China, either mandatory or voluntary, would largely increase the enforcement and regulation costs of supervisors, such as the MOF and the CSRC. First, even if the MOF adopts IFRS, it is expected that the MOF would continue to weigh in on the implementation of IFRS. For example, considering the Chinese-specific context, there are insufficient qualified accounting professionals who are competent enough to make appropriate interpretations of IFRS and judgments. Thus, the MOF would have to spend considerable budgetary and personal resources to provide interpretations and precise implementation guidance for principles-based accounting standards (Li, 2011).

Second, the MOF and the CSRC supervise the implementation of accounting standards in Chinese enterprises and the auditing of financial statements. The enforcement effectiveness of the MOF and the CSRC largely depends on their funding, research capability, and officials’ professional knowledge. Actually, even for the new set of CAS, supervising capacity (e.g., human capacity) development for accounting standards implementation has been an urgent issue for the regulators. For example, the World Bank pointed out that in order to improve the review of companies’ financial statements as well as the review of accounting firms’ and CPAs’ auditing practices, regulators in China, such as the MOF and the CSRC, need to recruit more technically qualified personnel who have the experience related with accounting and auditing standards implementation (World Bank, 2009). If the MOF adopts IFRS, the MOF and the CSRC would have to recruit specialized staffs that have practical experience related with IFRS implementation and auditing of IFRS-based financial statements. This would be a big challenge because only a small number of Chinese accounting professionals have adequate exposure to IFRS-related reporting and auditing practices (Wang, 2012).

Third, the CSRC anticipates that extensive application of fair value measurement would lead to a significant increase in supervision costs for financial reporting of listed companies. For example, Jia Wenqin, the Chief Accountant and the head of the Accounting Department within the CSRC, stated:

It is foreseeable that if fair value measurement is applied in China in a wide range as its application in the United States, this would lead to a large fluctuation in companies’ net assets and net profits in different accounting periods, and may provide more earnings manipulation opportunities to companies. This would significantly increase our supervision costs and bring unprecedented challenges to regulation. (Jia, 2010, p.9)

Moreover, the direct adoption of IFRS would bring a substantial financial burden for accounting firms, especially for Chinese domestic ones. Table 1 describes the auditing expenditure distribution for Chinese listed companies’ FY2013 annual reports. Table 1 shows that the major proportion (1,854 of 2,314) of Chinese domestic accounting firms’ clients paid audit fees under one million RMB. This data shows that the main clients of most domestic accounting firms were relatively small and medium-sized enterprises.
Hence, most domestic accounting firms may not have the experience in addressing complex accounting practices, such as estimating fair values of certain assets and liabilities. Chand et al. (2010) documented that appropriate training and adequate exposure to new accounting standards are essential for proficient and consistent interpretations and applications of the new accounting standards. The direct adoption of IFRS in China requires domestic accounting firms to build IFRS-specific capabilities, such as improving training of CPAs and furthering CPAs’ exposure to IFRS-related practices. This would be a great challenge for Chinese domestic accounting firms, because most of them have no experience in auditing IFRS-based financial statements. Thus, they have to pay huge costs to recruit new employees or re-train existing employees, and even to seek networks with international accounting firms to gain resources (e.g., procedure manuals, application guidance, and training) on the IFRS implementation tasks (Wang, 2012).

Table 1. Chinese Listed Companies’ Audit Expenditure for FY2013 Annual Reports

<table>
<thead>
<tr>
<th>Audit Fee (thousand RMB)</th>
<th>Number of companies</th>
<th>Proportion (%)</th>
<th>Number of the Big 4’s clients</th>
<th>Share of the Big 4 (%)</th>
<th>Number of domestic accounting firms’ clients</th>
<th>Share of domestic accounting firms (%)</th>
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<tbody>
<tr>
<td>Over 100,000 (including 100,000)</td>
<td>4</td>
<td>0.16</td>
<td>4*note2</td>
<td>100.00</td>
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<td>154</td>
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</table>

Source: Analysis of Auditing of Listed Companies’ FY2013 Annual Reports (CSRC, 2014).

Note1: 40 accounting firms, including the Big 4 and 36 domestic accounting firms, conducted auditing of Chinese listed companies’ FY2013 annual reports. The Big 4 includes Deloitte Touche Tohmatsu, KPMG, PricewaterhouseCoopers, and Ernst and Young.

Note2: These four companies have listed shares on the Stock Exchange of Hong Kong and prepared financial statements in accordance with IFRS in addition to financial statements in accordance with CAS.

Note3: These four companies have listed shares on the Stock Exchange of Hong Kong and prepared financial statements in accordance with IFRS in addition to financial statements in accordance with CAS.
Table 1 also shows that most Chinese listed companies (2,314 of 2,468) have been audited by domestic accounting firms. Thus, the lack of Chinese domestic accounting firms’ IFRS-specific capabilities would largely affect the entire auditing quality in China. This would hinder the IFRS adoption in China, because high quality auditing is one of effective enforcement mechanisms for the consistent implementation of IFRS.

Translation of IFRS

Literal translation of some accounting concepts and terms in IFRS is difficult because full equivalence in translation between English and Mandarin Chinese is rare. When an exact accounting terminology equivalent to an IFRS concept does not exist in Mandarin Chinese, translators tend to use the nearest equivalent. This may “lead to a blurring of meaning or loss of significant differences in the concepts” (Evans, 2004, p.211), because the nearest equivalent may be already applied in the Chinese context and defined differently from the concept in IFRS.

For example, there is no exact equivalent terminology in CAS to the accounting concept of “income”, thus, the China Accounting Standards Commission (CASC) within the MOF used the nearest comparable terminology, and translated “income” into Mandarin Chinese as “shouyi” (CASC, 2013, p.10). The terminology of “shouyi” in CAS is traditionally equivalent to profit or loss. For instance, “earnings per share” was translated into Mandarin Chinese as “meigu (means per share) shouyi (means earnings)” (MOF, 2006), and the concept of “earnings” is defined as “profit or loss from continuing operations attributable to the parent entity” and “profit or loss attributable to the parent entity” (IASB, 2016b, para.12). On the contrary, as the IASB stated that “an entity may use the term ‘net income’ to describe profit or loss” (IASB, 2016a, para.8), “income” does not necessarily mean a net amount deducting expenses, namely profit or loss. Thus, “shouyi” is not the exact Chinese equivalent to “income.” This example provides evidence that during the translation process from English to Mandarin Chinese, translators may use accounting terminologies that have already been linked with other concepts or ideas in CAS. This may lead users of the Mandarin Chinese-version of IFRS, such as preparers of financial reporting, auditors, investors, and regulators in China, to understand some important accounting concepts in a different way from the users of the English-version of IFRS.

In addition to the misunderstandings caused by literal translation, word used in translation may correspond to different connotations in the Chinese context. This also may lead users of the Mandarin Chinese-version of IFRS to make different interpretations of an accounting concept from the ones made by users of the English-version of IFRS. For example, Pan et al. (2015) found that Chinese students made significantly different interpretations of the principle of “control” and consolidation judgments, when they were given research instruments in English from when they were offered the same research instruments translated into Mandarin Chinese. Pan et al. (2015) further found the cause for the differences. The reason was that the word used in translation of “control,” namely “kongzhi,” has a connotation of the Chinese government’s “invisible power” over economy and accounting. This connotation affected Chinese students’ interpretations of the principle of “control” and consolidation judgments.

Besides translating IFRS into various national languages verbatim, adding precise guidance to IFRS by national accounting standards setters is another challenge for the global implementation of a single set of accounting standards. IFRS contain broad
principles and “uncertainty expressions” with the aim to guide judgments in practice. For example, IAS 17 Leases adopted uncertainty expressions, namely “major part” and “substantially all,”\(^5\) to prescribe the criteria for the classification of a lease as operating or capital lease. The MOF developed the accounting standard for leases by substantially adopting IAS 17, and included “for the major part of the economic life” and “substantially all of the fair value of the leased assets” criteria. The MOF translated “major part” into “dabufen” and “substantially all” into “jihu xiandangyu.” The MOF also provided guidance for the interpretation of “dabufen” and “jihu xiandangyu” as follows: “generally, ‘dabufen’ should be above 75% (including 75%) … ‘jihu xiandangyu’ should be above 90% (including 90%)” (MOF, 2006b). Previous studies have documented that the guidance added into principles-based accounting standards may affect accounting professionals’ judgments (e.g., Agoglia et al., 2011). Thus, precise guidance and bright-line thresholds provided by the MOF may lead to inconsistent judgments between Chinese accounting professionals and counterparts in countries without precise guidance to IFRS.

Training and Education

If the MOF adopts IFRS, it should strengthen IFRS-related training and education, which are essential to ensure the consistent interpretations and applications of IFRS in China. Indeed, the cost of IFRS-related training and education in China is expected to be higher than in Anglo-American countries, whose concepts and principles are mostly reflected in IFRS (Feng, 2001). The understanding of concepts behind each standard is essential to properly interpret IFRS, to make appropriate judgments, and to apply IFRS in the way intended by the IASB (ICAS, 2010). Actually, financial reporting preparers in Chinese companies and Chinese CPAs have been facing considerable difficulties in applying the IFRS concepts, such as fair value and impairment losses (World Bank, 2009).

The education about the reasoning and accounting models behind IFRS, which are different from those of CAS, is likely to be a challenge for China. This is because in most Chinese universities, there is a lack of well-trained and highly knowledgeable teachers to give instruction in the accounting environment and models in Anglo-American countries (World Bank, 2009). Furthermore, the accounting curricula in some Chinese universities focused only on CAS and Chinese auditing standards (World Bank, 2009). The university-level education in China has not yet significantly encompassed IFRS content to provide enough accounting professionals skilled in applying IFRS. Thus, the training burden will largely fall on the individual Chinese enterprises if the MOF adopts IFRS.

Actually, the MOF has acknowledged the shortage of skilled IFRS users as one of the urgent issues concerning IFRS implementation in China. In order to develop human resources to address the challenge of the global convergence of financial reporting, the MOF launched a 10-year plan in 2005, called ‘Leading Accounting Talent Project’ (lingjunrencai peiyangguihua), and trained 1,327 leading accounting talents who can apply both CAS and IFRS (MOF, 2016b). Candidates for this project have been selected from both public and private sectors, such as large companies, regulatory agencies, CPAs, and accounting academics (MOF, 2007). The MOF, in 2016, established the next 10-year plan, intending to increase the number of trainees in this project to over 12,000 until 2020, and over 17,000 until 2025 (MOF, 2016a). In developing high quality training and educational programs, the MOF has provided funds and played a leading role. The MOF also has collaborated with three National Accounting Institutes (NAIs),\(^6\) the Chinese Institute of Certified Public Accountants (CICPA),\(^7\) and the Accounting Society of China (ASC).\(^8\)
Furthermore, in order to implement the next 10-year plan, the MOF have to seek the cooperation of universities, national ministries, large companies, local governments, and accounting firms (MOF, 2016a).

Although the national talent training programs contribute to an increase in the number of skilled IFRS specialists, the amount of trainees is limited, and can only meet the human resources needs of a small cadre of Chinese enterprises, such as internationally oriented companies (Wang, 2012). The MOF showed its intention “to advance the use of IFRS within China and other related issues, especially for those internationally orientated Chinese companies” (MOF and IFRS Foundation, 2015) in the 2015 Beijing Joint Statement. This intention is consistent with the contemporary professional infrastructure in China. It is can be expected that the MOF’s decision concerning the adoption of IFRS in China would be cautious, in order to keep the accounting system compatible with the professional infrastructure.

**SUMMARY AND CONCLUSIONS**

This paper clarified several factors that may prove to be challenges in the direct adoption of IFRS in China, including the endorsement process, the interpretations of IFRS by the MOF and Chinese accounting professionals, the costs of IFRS implementation, the translation of IFRS into Mandarin Chinese, and the IFRS-related training and education. These factors are related with the Chinese-specific institutional arrangements surrounding accounting, such as the political system, taxation, and professional environment.

Even if the MOF directly adopts IFRS, the endorsement process may create “IFRS as endorsed by the MOF” with modifications and exclusions of IFRS to accommodate Chinese interests. Additionally, the time lag between the release of a standard by the IASB and its endorsement by the MOF is likely to hinder the comparability of financial reporting between Chinese enterprises and firms in other IFRS-adopting countries.

Findings of this paper suggest that Chinese accounting professionals may face problems in consistently interpreting and applying IFRS if the MOF directly adopts IFRS. The MOF is likely to provide interpretations and guidance to facilitate the consistent implementation of IFRS in China. However, precise guidance by the MOF may affect accounting professionals’ independent judgments, and lead to different accounting treatments for the same transactions and economic events in Chinese enterprises compared to those in other IFRS-applying enterprises. Thus, direct IFRS adoption may not necessarily lead to an improvement in the comparability of financial reporting across countries.

The direct adoption of IFRS is expected to cause high implementation costs for Chinese enterprises. The costs would be prompted by the need to recruit accountants qualified at applying IFRS or re-train exiting accountants with IFRS-related knowledge and skills. Additionally, the direct adoption of IFRS would largely increase the enforcement and regulation costs of regulators, such as the MOF and the CSRC. The main costs that have been identified by this paper are led by establishing interpretations and precise implementation guidance for principles-based accounting standards, updating the officials’ professional knowledge, and preventing opportunistic applications of accounting standards that give more discretion to managers. Furthermore, as most Chinese domestic accounting firms have no experience in auditing financial statements prepared in accordance with IFRS, they need to devote great financial resources to foster IFRS-specific capabilities, such as training CPAs and developing procedure manuals.
The proper translation of IFRS from English to Mandarin Chinese would also be a challenge for the direct adoption of IFRS in China. This is because the words in Mandarin Chinese used to translate the concepts in IFRS may have been already applied in the Chinese context and defined differently from the original meanings in IFRS. Improper translation may lead to inappropriate interpretations and applications of IFRS.

The IFRS-related training and education would pose another challenge. Although the MOF conducted training programs to foster Chinese accounting professionals’ competence in applying IFRS, the trainees in these programs have been limited to a small cadre of elites. In order to enlarge the supply of qualified accountants and auditors to apply IFRS, the MOF should seek the cooperation of various organizations, such as universities, large companies, and accounting firms.

This paper clarified Chinese institutions’ constraints on the implementation of IFRS. Findings of this paper showed that IFRS could be incompatible with the current political, professional, and societal environments in China. The incompatibility could bring practical problems, such as the inconsistent interpretations of IFRS and improper translation of IFRS from English to Mandarin Chinese. Moreover, the incompatibility might produce unintended consequences in China, such as opportunistic applications of accounting standards. Certain adjustments to Chinese-specific institutions should be made to adapt them to IFRS implementation. These adjustments would bring significant costs to Chinese stakeholders, including enterprises, regulators, and accounting firms.

Findings of this paper have important application for the IASB, which has been promoting the global adoption (either mandatory or voluntary) of IFRS. Given the complex interactions between accounting and surrounding institutions, in order to achieve the de facto global convergence of financial reporting, the IASB should extend discussions concerning the convergence of financial reporting from simple accounting issues to a more holistic perspective, including institutional diversity surrounding the financial reporting in individual countries, and how to improve the adaptability of national-specific contexts to IFRS.

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ENDNOTES
1. The direct adoption of IFRS in this paper indicates that: applying IFRS as issued by the IASB without modifications, or applying IFRS as endorsed by regional or national regulators (e.g. the European Commission) with potential deletions or modifications (e.g. the “carve-out” from IAS 39 Financial Instruments by the EU).
2. The secondary sector, such as mining and manufacturing industries, contributed largely to Chinese GDP. For example, 42.7 percent of Chinese GDP in FY 2014 came from the secondary sector (National Bureau of Statistics of China, 2015).
3. The amount of funds raised in Chinese domestic capital markets through direct financing reached a peak of 10,190.93 million RMB in 2010. This amount only accounted for 12.8 percent of bank loans in the same year (CSRC, 2013).
4. The number of CPAs per one million in China is approximately 159 (215,091/1,350 mil.), while in the United States, it is 1,087 (342,490/315 mil.), meaning that China only has
one-seventh the number of CPAs per one million as the United States. Importantly, according to the regulations of the MOF and the CSRC, less than 0.5 percent of accounting firms (40 of 8,350), and consequently, only about 11 percent of CPAs (about 24,146 of 213,376) in China are eligible to audit listed companies (Miao, 2016, p.152).

5. In January, 2016, the IASB issued IFRS 16 Leases to replace IAS 17 Leases. IFRS 16 Leases also adopted probability expressions of “major part” and “substantially all” to prescribe the criteria for the classification of a lease as operating or capital lease (IASB, 2016c, para. 63).

6. Three NALs were established in the early 2000s in Beijing, Shanghai, and Xiamen. The NALs are government-funded institutes to provide accounting-centered trainings to Chinese accounting professionals.

7. The CICPA is a self-regulatory organization of Chinese CPAs. The CICPA is under the guidance of the MOF and the State Council.

8. The ASC is a self-regulatory organization of Chinese accounting academics, and is under the guidance of the MOF.

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