Globalization of Accounting Standards & China’s Role in It

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Benefits of globalized accounting standards

Brief History

• In 1973, International Accounting Standards Committee (IASC) was established
• In 2001, the organization restructured into International Accounting Standards Board (IASB)
Major driving factors

- Cross board listing
- Cross board mergers and acquisitions
- Growth of multinational companies
- Regional economic cooperation
- For developing and transitional economies
  - attracting foreign investment
  - lower standard-setting cost
  - global financial crisis

Benefits to companies

- One set of books
  - Easier consolidation
  - Integrated IT system and better internal control system
  - Enhance understanding of financial statements of overseas suppliers, customers, subsidiaries
  - Easier to deal with tax authorities, regulators in different jurisdictions
  - Assist in raising capital overseas with lower cost
The views expressed in this presentation are those of the presenter, not necessarily those of the IASB or IFRS Foundation.

April 2013 Project update and the future work plan.

Major development stages

From 2001 when IASB was established, its technical agenda can be divided into three major stages:

First stage: 2001-2005
- Establish comprehensive set of standards to facilitate the adoption of IFRSs by EU countries, Australia, South Africa and Hong Kong

Second stage: 2005-2011
- Focus on converged programs with FASB and enhance quality of IFRSs to facilitate
  - adoption decision by US and other jurisdictions, and
  - further improve quality of financial reporting
Major development stages

- Third stage: 2011-
  - While more and more jurisdictions are joining IFRSs family, IASB and FASB failed to finalize the major convergence projects, and SEC did not make final decision on transition to IFRSs, as planned in 2011
  - This symbolized the end of the period of unique relationship between IASB and FASB, and the start of a new era
  - Moving into new era, IASB has to set its agenda based on the needs of worldwide constituents
  - Its agenda will not be dominated by the convergence projects with one country: the US
Worldwide adoption of IFRSs

• When IASC restructured into IASB based on FASB model in 2001, no county used IFRSs (then IASs) at all
• Today, more than 100 jurisdictions are using IFRSs
• When countries are considering their adoption or convergence policy, IFRSs has become the only choice
• 40 years after creation of IASC, and 12 years after the establishment of IASB, the vision to establish global accounting standards has become a reality

124 Jurisdictional profiles are on IFRSs website

http://go.ifrs.org/global-standards

<table>
<thead>
<tr>
<th>Region</th>
<th>Jurisdictions</th>
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<tbody>
<tr>
<td>Africa</td>
<td>18</td>
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<tr>
<td>Americas including</td>
<td>32</td>
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<td>Caribbean</td>
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<td>Europe</td>
<td>42</td>
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<td>Middle East</td>
<td>6</td>
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Public Commitment to IFRSs as global standards

- Yes: 118 of the 124 jurisdictions
- No: 6
  - Switzerland*
  - Bermuda*
  - Cayman Islands*
  - Suriname*
  - Egypt
  - Macao

*IFRSs permitted and widely used. In Switzerland, 84% of companies on main board of Swiss Exchange now use IFRSs

IFRSs already adopted

- IFRSs required for all or most listed companies?
  - Yes = 101 of 124 jurisdictions (81%)
  - Not yet = 23 jurisdictions (see next slide)

- Most of those 101 go beyond just listed companies and financial institutions:
  - 60% also require IFRSs for all financial institutions and/or large unlisted companies
  - 90% also require or permit IFRSs for many unlisted companies
On the road to adoption of IFRSs

• IFRSs are already used in most of the 23 jurisdictions that do not yet require IFRSs for all or most listed companies:
  ▪ 12 permit IFRSs for all or most listed companies
  ▪ 2 require IFRSs for all financial institutions
  ▪ 2 are in process of adopting IFRSs
  ▪ 7 use national GAAP

Four major non adopters

• US
  • Have not decided to adopt
  • But started to allow foreign issuers to file IFRSs based financial statements without GAAP difference reconciliation in 2007

• China
  • Started to implement continuous and full convergence policy in 2005
  • But most large companies listed in both domestic and international markets and use IFRSs for foreign investors
Four major non adopters

- **Japan**
  - Also under convergence process
  - But has started to allow local companies publish IFRSs based statements

- **India**
  - Under convergence process too
  - But has allowed a few companies publish IFRSs based statements

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April 2013 Project update and the future work plan.
Major challenges-1

- Unclear picture of US approach towards IFRSs creates negative impact on the establishment of one set of high quality global standards:
  - Delay the finalization of major convergence projects
    - Revenue
    - Leasing
    - Financial instrument
    - Insurance
  - A few countries may take convergence rather than adoption approach
  - A few other countries may postpone their decision

Major challenges-2

- After recent financial crisis, entities in major economies become very sensitive to the economic consequences of new IFRSs requirements
- Such sensitivities may vary among entities or economies, making standard setting more difficult
Major challenges-3

• IASB faces some fundamental conceptual dilemmas:
  – Principle or rule based
  – Balance sheet or income statement focused
  – Stress relevance or reliability
  – Use more fair value or other measurement attributes
  – Should its Conceptual Framework and standards be neutral or biased (conservative)
  – How to balance between transparency and volatility

Major challenges-4

• Since more than 100 jurisdictions are using IFRSs, it has become a very challenging task for IASB to respond to the technical inquiries from all over the world
  – Pervasive principle or country specific medication
  – Asked for quick response but also required to follow due process
  – Again, principles or rules based
Major challenges-5

- Ongoing debate on information shortage or overload
  - Sophisticated, institutional investors: the more the better
  - Others: too much, important information is obscured, even experts feel it is hard to understand published information
Long history

- China has thousands of years of accounting history.
- Before 1949, combined traditional Chinese bookkeeping system and western accounting system gradually forged from industrial revolution.
- After 1949, adopted accounting system from former Soviet Union to facilitate planned economic system.
- 1987, started to apply ‘reform and open door’ policy.
- From then, some reforms in China’s accounting system, but not fundamental.

Two complete reforms from early 1990s

- Beginning of 1992, Deng Xiaoping paid historical visit to south China, the Chinese government decided to transform the economic system into a market oriented one.
- The same year, abolished uniform accounting systems designed for planned economy, and replaced by a series of accounting standards, plus fewer sets of accounting systems.
- From 2006, abolished two tiers system, replaced by single set of accounting standards significantly converged with IFRSs.
Why China supports IFRSs & converged with the standards

- China has been oriented towards a market economy
- Development of capital market
- Globalization of Chinese economy
  - Cross board listing
  - International trade

Why China takes convergence rather than adoption approach

- Language barrier
- Legal tradition
- Development stages and complexity of business transactions
  - Pension
  - Safety fund in mining industries
- Ability to use principle based standards
  - Options related to fair value measurement
  - Reversal of impairments
Why reported differences are smaller than that based on written standards

- Many detailed requirements in IFRSs are not relevant to Chinese companies
- China’s choice of some options in IFRSs are not considered as GAAP differences
- Companies are allowed to apply IFRSs requirements when they are not covered by Chinese standards
- Chinese regulator has not allowed differences in accounting policy and estimates since 2002
- Most disclosure requirements in IFRSs are covered in securities regulations, not considered as GAAP
China is now an important part of IASB’s standard setting structure

• Trustee
• IASB
• Interpretation council
• ASAF: 1 of 12
• Advisory council
• Working groups
• Emerging Economies Group
• Asia Oceania Standard Setters Group

Next step(s) ?

• Hard to predict China will adopt IFRSs fully in the foreseeable future
• Continuous and full convergence
  – new or revised Chinese standards will be more close to IFRSs in terms of content and structure
• International board in Shanghai Stock Exchange
  – Allow foreign companies to use IFRSs
• Allow AH share Chinese companies
  – publish IFRSs based statements in local market
  – assert dual compliance with Chinese standards and IFRSs
What else China needs to do?

• Enhance knowledge of complicated financial transactions and their accounting standards
• Improve the competence to use principle based standards
• Prevent and punish frauds to manipulate financial information
• Prevent and properly react to possible negative impacts of implementing IFRSs based standards
• More actively participate in the standard setting process

How am I playing the role as IASB member

• The first board member from China, the second from Asia, and the first one from transitional economy.
• Play my role on the following principles:
  – be independent, technically oriented, and collegiate
  – try to reflect more the concerns and ideas from developing and transitional economies
  – say no if necessary but carefully use veto power
Concluding remarks

- In a short period of time, IFRSs has become global basis of financial reporting
- Such a overall trend has been and will be significantly influenced by the possible US decision to move to IFRSs
- In addition, IASB are facing other major challenges
- But, the momentum is unchangeable
Concluding remarks

- Chinese accounting standards are now very close to IFRSs, but more works need to be done
  - to more actively participate in the IASB’s standard setting process
  - to ensure continuous and full convergence
  - to ensure the quality of financial reporting in the country

Thank you