Tutorial 04: Comparative Accounting – Accounting environments in five countries
1. Peoples Republic of China (PRC)

**Background**

The ultimate legislative authority in China rests with the National People’s Congress. It has the power to amend the constitution, select the president, approve the national economic plan, state budget, decide on questions of war and peace etc.

With the formation of PRC in 1949 the government adopted a policy of public ownership and centralized management of business and economic resources. Private companies were transformed to state or collective ownership.

However the state owned enterprises eventually proved to be an economic failure with most of such enterprises incurring significant losses.

This lead to the need of economic reforms, which was aimed at transforming the centrally planned economy into a socialist market economy. This is a market based economy model with socialist principals.

Under these reforms private enterprises, corporative and joint ventures coexist and compete with state run entities.

Further China opened its doors to foreign direct investments (FDI). Today, there are about half a million foreign investment entities in China, with parent entities in more than 170 countries.

In early 1990’s China opened its stock exchanges in Shanghai and Shenzhen to facilitate the non-governmental ownership and FDIs. The number of listed entities in the two exchanges has increased from 50 in 1992 to over 3000 companies at present. Shanghai stock exchange is the 5th largest stock exchange in the world today.

Today, the socialist market economy of China is the world’s second largest economy by nominal GDP. Further China has one of the world's fastest growing economies, with growth rates averaging 10% over 30 years. However, China reported 6.1% growth rate in 2019 - the worst figure in 29 years.

China’s accounting practices were often criticized for falling short of those set of IASB. An accounting practice aimed at measuring how well production targets are met in a planned economy was largely incapable of meeting the requirements of a market economy. For example the historical financial statements of China provided no measure of profit or loss, and there were no measures of debts of the company.

**Accounting profession**

In the ancient society under thousands of years under feudal system, people respected scholarly officials (politicians and government officials appointed by the emperor of China who had earned academic degrees) and looked down on merchants. Accounting for business was viewed as a non-skilled profession.

In early 1900’s university study in accounting became an accepted way to understand and advance the principals and practice of accounting.

The first local professional accounting body, the Chinese Chartered Accountant’s Society of Shanghai was established in 1925.

By 1947 there were over 2000 certified Accountants in China.
Scholars returning home after completing their studies abroad, mainly in Soviet Union, pioneered the development of the body of knowledge in China.

The economic reforms and the open door policy introduced in 1980 brought about a large number of Sino-foreign joint ventures in China. This resulted in the reemergence of private auditing profession. The Chinese institute of Certified Public Accountants (CICPA) was formed in 1988.

Unlike in USA and UK the accounting and auditing took different paths in its development. Accounting firms were sponsored by the Ministry of Finance, while the audit firms were under the state Administration of Audit (SAA) a department within the State Council responsible for government audits.

In 1991 SAA issued “Tentative rules on Certified Public Auditors”

In 1992 the Chinese Association of Certified Public Auditors (CACPA) was formed under the auspices of SAA.

The competition between Accountants and Auditors with their own rules issued by different government departments was confusing.

Consequently, steps were taken to merge CICPA and CACPA, and Ministry of finance was given the authority to regulate both the accounting and auditing professions.

In 1997 CICPA became a member IASC (and IFAC).

The opening up of the Chinese economy and the inflow of foreign investments created demand for audit of financial statements, which was an opportunity for the international accounting firms to enter the Chinese market.

More than 200 of the world’s largest 500 companies have invested in china. All the leading international accounting firms, following their clients, have moved in to China by opening representative offices.

**Guanxi**

Guanxi (pronounced gwon-she) is a Chinese term meaning "networks" or "connections" is a central idea in Chinese society. It open doors for new business and facilitate deals. A person who has a lot of guanxi will be in a better position to generate business than someone who lacks it.

The odds of gaining access to a business opportunity and then winning that opportunity are higher when you work your connections. If you are bidding for a contract in competition with others and you know someone on the other side of the deal, naturally you will try to utilize this contact to your advantage.

In recent years, the ethical consequences of guanxi have been brought into question. While guanxi can bring benefits to people directly within the guanxi network, it also has the potential to bring harm to individuals, societies and nations when misused or abused.

e.g. Insider dealing, corruption, unfair-trading, compromised independence.
**Accounting regulation**

Government continues to act as the accounting regulator in order to retain political control.

Direct government involvement in accounting regulation in China is a political tradition that originated in the era of central planning.

In Anglo-American countries setting accounting standards is a responsibility of the accounting societies / professional bodies, whereas in China it is the responsibility of Ministry of Finance.

In recent years accounting regulation in China has been influenced mainly by China’s desire to harmonize domestic accounting practices, and to harmonize Chinese accounting with IFRS. As foreign investments flooded to China it created a need to international harmonization.

The China Accounting Standard Committee (CASC) – comprising government experts, academics and members of accounting firms was established within the MoF in 1998.

On 15 February 2006, the Ministry of Finance of the People’s Republic of China issued a new set of Accounting Standards for Business Enterprises (ASBEs), which are substantially converged with IFRSs.

All companies listed in China must apply ASBEs for the preparation of their financial statements. Application of IFRSs as issued by the IASB is not permitted. Further convergence with IFRSs is an ongoing project. Based on the Roadmap for Continuing Convergence of Chinese Accounting Standards for Business Enterprises with International Financial Reporting Standards released by the Ministry of Finance of China in April 2010, ASBEs will be revised and improved in accordance with the revision and improvement of IFRSs, in order to continue convergence.

Chinese companies whose securities trade on the Stock Exchange of Hong Kong may choose among IFRS, Hong Kong Financial Reporting Standards (HKFRS), and Chinese Accounting Standards (ASBE) for purposes of financial reporting to Hong Kong investors. However, those financial reports are in addition to the ASBE financial reports that the Chinese companies issue within mainland China.
2. Germany

Background

After the Second World War Germany was divided into American, French, British and Soviet zones of occupation. In 1949, the Federal Republic of Germany was created out of the western zones and the communist lead German Democratic Republic was established in the Soviet zone.

The two zones were reunified in 1990, symbolized by the falling of Berlin wall.

There are eight stock exchanges in Germany, with Frankfurt Stock Exchange (FSE) being the main one. FSE is one of the world’s first stock exchanges next to London and Paris.

Traditionally the primary source of finance for German companies is bank loans, rather than equity raised through the capital markets. In Germany Banks not only provide loans to companies but also control major portions of their equity capital, either directly or as trustees for their customers.

Since reunification, German accounting has been greatly affected by the increasing internationalization of the economy and growing integration of the world’s capital markets.

Historically, Germany has had a considerable influence on the accounting systems in many countries, especially Japan, Austria, Switzerland, and some Nordic countries such as Denmark and Sweden.

Accounting profession

Auditing dominates the financial reporting related professional activities in Germany.

The Institute of Auditors in Germany, comprises over 11,000 public auditors and over 900 public audit firms. This represents about 85% of the profession. The institute provides education and continuing professional development. Publishing accounting and auditing standards is a responsibility of the Institute of Auditors.

There are stringent requirements to become an auditor as defined by Law. These generally include, a university degree in Business Administration, economics, engineering or agriculture; passing separate exams covering accounting, auditing, law taxation, economics; four years practical experience including two years in auditing.

The German auditing profession in much smaller than some of the other developed counties. E.g. 11,000 auditors (population approx. 85Mn), compared to 250,000 in USA (population approx. 300Mn)

The auditing profession is headed by the Chamber of Auditors, an independent organization responsible for the supervision of its members and for representation of the profession to other parties. All public accountants are mandatorily members of the Chamber.

There also is a second-tier body of certified accountants. The requirement to become a certified accountant is less than a certified auditor. Certified accountants are only allowed to perform voluntary audits and audits of medium sized limited liability companies.

A third type of professional accountant in Germany are the Tax advisors, who focus on offering tax services to clients.
Accounting regulation

Financial reporting in Germany is dominated by commercial law, tax law and pronouncements issued by the profession.

A stock corporation (a company with shares issued to its shareholders), is required to prepare statutory annual financial statements prepared in accordance with German principals of accounting. Parent companies are required to prepare consolidated annual financial statements (with aggregated results of the entities of a group of companies).

In Germany the principal of prudence (conservatism) has predominance, and is clearly established by law. Accordingly, profits must be recognized only when certain to be realized, but losses should be recognized as soon as they appear possible.

In 1965 The Companies Act was enacted, along with changing of the financial reporting orientation from creditors to shareholders.

More recently German accounting regulation has been heavily influenced by EU directives.

In 1998, German law was amended to allow a private sector body to develop accounting standards. Accordingly, the German Accounting Standard Committee (GASC) was created in May 1998.

GASC has two standing committees:

a) German Accounting Standard Board (GASB)

b) Accounting Interpretations Committee (AIC)

In recent years, the IFRS has gain popularity in Germany due to strong international acceptability and increased transparency.

With growing pressure on national standard setters and legislators to converge with IFRS, GASB was given the task of adopting German accounting principles to international norms by 2004.

Adoption of IFRS

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Accounting principles and practices

German financial reporting requirements are mainly based on the commercial code.

Given the traditional role Bank credit / loans have played in corporate finance, the principal of creditor protection plays an important role in German accounting practices. Accordingly, the primary function of financial accounting is the conservative determination of distributable income. Here the profit shareholders could withdraw from the business should only be arrived at after ensuring the possibility of payments to the creditors and the long-term prospects of the company.

The information needs of the investors (representing a true and fair view) is not the primary focus in financial reporting.
Traditionally German accounting is heavily influenced by tax law. Generally financial statements are the basis for taxation. Hence there is minimum difference between accounting income and taxable income. Therefore, financial reporting is also influenced by the desire to minimize taxes.

The conservative measurement of income in Germany is also influenced by a desire to mitigate labour union demands for higher wages and to report stable income over time for dividend purposes.

Globalisation and EU directives have had an impact on the German accounting in recent times. Accordingly more and more German companies are preparing IFRS based financial statements, which is a move towards, *true and fair view* reporting. Since 2005 all German listed companies have been required to use IFRS in preparing consolidated financial statements.

3. Japan

**Background**

A unique aspect of Japanese business is cross-corporate ownership. About 70% of the equity shares of listed entities are cross-owned by corporate shareholders such as financial. Institutions and other companies.

The manner in which business is organized in Japan reflects its cultural value of collectivism.

The way in which businesses are financed influences financial reporting. The main source of finance for Japanese businesses are through bank credit and cross-corporate ownership. In additions to providing credit, Banks also have control over major portions of corporate equity capital. Therefore, as “insiders” banks have access to their client’s financial information, hence there is less pressure for public disclosures. This explains the relatively low level of information in annual reports of Japanese companies.

The heavy reliance on bank credit and long-term nature of the cross-corporate equity ownership means there is less emphasis on short-term results in Japanese companies compared to the United States. Corporate earnings are regarded as a source of funds that can be distributed, at the discretion of the shareholders, rather than as a measure of corporate performance.

With the major recessionary pressure experienced by the Japanese economy in 1990s the ability to raise capital from the domestic market contracted. As the need to attract foreign investments grew, Japanese businesses and regulators found it necessary to respond to the demands of the international capital markets.

**Accounting profession**

In 1927 the Institute of Professional Accountants came into existence with the enactment of the Accounting Law.

Currently, members of the accounting/auditing profession in Japan practice with the title Certified Public Accountants (CPA) under the Certified Public Accountants Law, legislated in 1948. The CPA law established the Japanese institute of Certified Public Accountants (JICPA). This can be considered the beginning of the modern accounting profession in Japan.

The requirements one must fulfill to become a CPA is rigorous (which include series of examinations and practical training), therefore the number of CPAs in Japan is relatively low.

JICPA has been heavily involved in the international harmonization process, being one of the nine founding members of IASC.
Because of the cultural value of collectivism, an independent auditor in Japan does not fit in the role of someone to be trusted or relied upon. Japanese companies do not usually trust outsiders that includes Auditors.

The process of setting accounting standards was initially driven by the Ministry of Finance. This was changed with the establishment of Financial Accounting Standard Foundation (FASF) in 2001. The Accounting Standard Board of Japan (ASBJ) was established under the FASF as an independent private-sector entity to develop accounting standards in Japan. In 2005, the ASBJ announced the launch of a joint project with IASB aims at achieving convergence between Japanese GAAP and IFRS.

**Accounting regulation**

Accounting and financial reporting in Japan is regulated by three types of law:

a) Commercial Code
b) Securities and Exchange Law
c) Corporate Income Tax Law

**The Commercial Code** of Japan is administered by the Ministry of Justice. It was enacted in 1890 and is heavily influenced by the German Commercial Code. In relation to financial reporting, the Code specifies matters such as, the minimum content of the financial statements that should be included in an annual report, and the requirement to prepare consolidated financial statements for “Large Corporations” (as defined by the Code)

**Securities and Exchange Law (SEL)** for listed companies was enacted in 1948 and is administered by the Ministry of Finance. In 1951, the SEL required the listed entities to be audited by CPAs. This requirement was added to the Commercial Code in 1974. SEL overtime has been influenced by the US Securities and Exchange Commission regulations.

Financial reporting in Japan is strongly influenced by tax law. The **Corporate Income Tax Law** in Japan provides methods for calculating taxable income and requires revenue and expenses to be recognized in the books of accounts in accordance with the tax law. Depreciation, allowance for bad debts, profits from installment sales are examples of accounting issues that are generally reported in financial statements in conformity with tax law.

Japanese economy experienced rapid growth from mid 1950s to the 1980s. In late 1980s however the exports and stock prices started to fall and the economic growth came to a halt. In response to it the Japanese government announced a strategy for financial reforms in 1996, which included reforming the financial reporting system.

One of the major objective of these reforms was to make the Japanese Accounting Standards fall into line with international standards. Accordingly, the government's influence via different legislations were lessened and private sector bodies such as the Financial Accounting Standard Foundation (FASF) and the Accounting Standard Board of Japan (ASBJ) were given more authority relating to the standard setting process and financial reporting.
Accounting principles and practices

Disclosure requirements of Japanese companies are based on the Commercial code, SEL and ASBJ accounting standards.

Corporate earnings are regarded as a source of funds that can be distributed, at the discretion of the shareholders, rather than as a measure of corporate performance.

Financial reporting practices in Japan reflect some of the inherent cultural values in Japan society. There is reluctance to share information with outsiders and treating the external audit function as an inconvenience and a reluctance to voluntarily disclose information publicly.

Efforts have been made in recent time to bring Japanese accounting principles and practices closer to international standards.

In 2007 ASBJ and IASB jointly announced an agreement (known as the Tokyo Agreement) to accelerate the process of convergence between Japanese accounting standards and IFRSs.

As a further step towards adopting IFRS in Japan, in 2010 regulatory changes were announced that permitted domestic use of IFRS as an accounting framework in the preparation of financial statements.

4. Mexico

Background

Mexico was conquered by the Spanish in 1519 and became an independent nation in 1821. It is one of the most populated Latin American countries, with current population in excess of 123Mn. Mexico is a federal republic consisting of 31 states and a federal district (Mexico City). Mexican states do not have separate or different laws. The legislative authority of the country rests with the President and the Congress.

Until about two – three decades ago most of the business were controlled and owned by the government. There are certain industries that are owned by the government (e.g. exploration and refinement of oil, distribution of electricity).

From mid 1970s until the late 1980s, Mexico experienced persistent balance of payment problems resulting from the government’s effort to defend the overvalued Peso and incurring massive external debt.

In recent years there had been a major effort to privatize state-owned enterprises as part of a new economic program designed to achieve long-term economic growth. Most restrictions on investments by foreigners have been removed opening the door to external capital.

This process has further strengthened by the North American Free Trade Agreement (NAFTA) entered into between Mexico, USA and Canada.

In 1994, Mexico devalued the peso and plunged into financial crisis, as it could not pay billions of dollar denominated short-term bills. To come out of the crisis Mexico accepted US$40Bn bailout package from the US Treasury and IMF, which came with some tough conditions. Mexico managed to come out of this crisis within relatively short period of time.

2009 financial crisis (which also affected US and a number of other European countries), had a devastating effect on Mexico as well.
Accounting profession

The Mexican Institute of Public Accountants (MIPA) was established in 1964. MIPA is an independent non-governmental professional organisation governed by three bodies:

a) The General Conference of Members
b) Governance Group
c) National Executive Committee

The first two bodies mainly perform sponsoring and oversight functions, whereas the NEC’s major responsibilities relate to the day-to-day activities of MIPA. Responsibilities of MIPA include:

i. Oversee the professional conduct of its members.
ii. Investigate complaints against members with regard to professional conduct.
iii. Establish continuing professional education requirements to its members

MIPA conducts examinations for those qualifying accountants who intend to obtain the title Certified Public Accountant (CPC in Spanish). Mexican CPC is considered equivalent to the CPAs of US and Canada

Mexican Board of Research and Development of Financial Reporting Standards (CINIF in Spanish) is responsible for issuance of Mexican Accounting Standards.

Accounting Regulation

The accounting regulation in Mexico is through legislation, stock exchange listing requirements and accounting standards.

Mexican law requires all companies to be audited by a Mexican CPA.

Accounting standard setting in Mexico takes an Anglo-American approach rather than a Continental European one (despite the countries Spanish influence).

National Banking and Securities Commission (NBSC) is the most important federal agency that oversees information disclosure by publicly owned companies in Mexico. It is a semi-independent entity within the Ministry of Finance.

Until 2004, Accounting Standards were the responsibility of the Accounting Principles Commission of MIPA. Since June 2004 CINIF assumed the duties and responsibilities for issuance of Mexican Accounting standards. The standards previously issued by MIPA were called “Generally Accepted Accounting Principles in Mexico” (Mexican GAAPs), the standards issued by CINIF are called “Financial Reporting Standards” (FRS).

Mexican FRSs are very similar to US GAAPs and IFRS.

Similar to the requirements of the Sarbanes-Oxley Act in USA, since 2003 the CEO and CFO of a listed entity must certify the completeness and accuracy of its quarterly and annual financial statements.

Accounting principles and practices

Mexican FRSs are known as bulletins.

The generally accepted accounting principles in Mexico consist of the following, in order of its importance:

a) CINIF (Formally MIPA) bulletins.
b) CINIF (Formally MIPA) circulars or interpretations. These are opinions relating to specific topics on which there may or may not be a specific standard. Compliance with these is not mandatory, but highly recommended.

c) International Financial Reporting Standards
d) Accounting principles of other countries that would be applicable in the circumstances. In practice, US GAAPs are the main source applied.

In recent years Mexican accounting principals have been heavily influenced by the US accounting practice due to Mexico’s membership in NAFTA.

MIPA being one of the nine founding members of IASC has shown keen interest in international harmonization of accounting standards.

US had a dominant influence in Mexican Accounting. However, US GAAPs did not always meet the Mexican requirements. For example Latin American financial reports are prepared for creditors, owner-managers, and tax collectors while accounting standards and financial reports in the US are directed towards investors. As a result the standard setters of Mexico have also looked at the “Principal based” IFRS as a reference for upgrading Mexican GAAPs. This is a sign towards convergence with IFRS in recent years.

## 5. United Kingdom

### Background

United Kingdom constitute of four constituent regions: England, Wales, Scotland and Northern Ireland. Legislative authority lies with Parliament, which include the House of Commons (659 directly elected members) and the House of Lords (consist of hereditary peers, certain senior judges, Bishops of the Church of England etc).

Limited Liability Company is the main form of business in the UK, and Capital market provides the main source of funding. Therefore, facilitating the efficient working of the capital market is the primary purpose of accounting.

UK has the largest number of entities listed in a regulated market in the European Union.

### Accounting profession

Accounting in the UK grew as an independent discipline, responding to business needs. It has had significant influence on the development of the accounting profession in many countries (Canada, Australia, New Zealand etc).

There are six professional accounting bodies in the UK. In order of its membership size, these are:

1. The Institute of Chartered Accountants of England and Wales (ICAEW)
2. The Association of Chartered Certified Accountants (ACCA)
3. The Chartered Institute of Management Accountants (CIMA)
4. The Institute of Chartered Accountants in Scotland (ICAS)
5. The Chartered Institute of Public Finance and Accountancy (CIPFA)
6. The Institute of Chartered Accountants of Ireland (ICAI)

The ICAEW alone has more than 140,000 members and is the largest professional accounting body in Europe.
The activities of the six bodies are coordinated through the Consultative Committee of Accountancy Bodies (CCAB), established in 1974.

Members of CIMA and CIPFA are not allowed to sign audit opinions.

All six professional accounting bodies set comprehensive exams for admission into their bodies. The aspiring members are also required to enter into training contracts in approved organisations and obtain the relevant experience before being admitted as members.

Over the years there had been several attempts to consolidate the UK accountancy profession by merge of the three professional bodies (ICAEW, CIMA and CIPFA); however, this has not materialized as a result of the inability to reach an agreement on some aspects of the merger.

**Accounting regulations**

Regulation of accounting and financial reporting in the UK is primarily through legislation (Companies Act), professional pronouncements (Accounting Standards), and stock exchange listing requirements.

EU directives also have had a strong influence on the UK accounting regulation. These directives are transformed into UK legislation through Companies Act.

Traditionally, the determination of acceptable accounting principles and standards was left on the hands of the accounting profession. Recent developments however, suggest a change in this attitude, as the Financial Reporting Council (FRC) has become a powerful independent regulator responsible for promoting confidence in corporate reporting and governance.

In 2000, British government in partnership with the professional accounting bodies, established the Accountancy Foundation, to be responsible for the independent regulation of the six professional chartered accountancy bodies. Purpose of the foundation was to ensure self-regulation of the professional accounting bodies would be conducted in public-interest.

Another main element of the UK regulatory system is the professional pronouncements.

The establishment of the Accounting Standard Steering Committee in 1970 by ICAEW was the development of formal accounting standards in the UK. The committee was later re-designated as the Accounting Standard Committee (ASC), as a joint committee of the six professional bodies.

In 1980s ASC came into heavy criticism due to low quality of its standards and for lack of effective means of monitoring compliance. In response, following bodies were created:

1. The Accounting Standard Board (ASB) – with the authority to issue accounting standards.
2. The Financial Reporting Council (FRC) – with the responsibility of overall policy control over the standard setting process.
3. The Financial Reporting Review Panel (FRRP) - to oversee compliance

ASB is institutionally separated from the accounting profession and hence with its creation in 1990, the direct influence the accounting profession had on standard-setting reduced.

Following the major corporate collapses in the US (Enron, WorldCom), in 2003 the government announced a package of reforms, which include FRC taking over the responsibilities of the Accountancy Foundation. Accordingly FRC became the single, independent regulator of accounting and auditing in the UK.
Accounting principles and practices

Accounting principles in the UK are developed primarily emphasizing on the needs of the investors.

Companies are required to prepare financial statements to provide a True and Fair view of the company’s financial position and performance (results of operations). Auditors are given the corresponding responsibility to render an opinion on whether the financial statements do present a True and Fair view.

Since 2005, UK listed entities are required to prepare its group financial statements (consolidated financial statements) following IFRSs. They are also permitted (but not required) to use IFRSs for their individual accounts.

Other companies (non-listed entities) are permitted (but not required) to use IFRSs for their consolidated and individual accounts.