

Research Note

The Impact of Regulatory Enforcement on Harmonization of Accounting Practices: Evidence from China

Jean J. Chen* and Peng Cheng*

University of Surrey

Received July 2005; Accepted March 2007

Abstract

This paper evaluates China's regulatory enforcement in 2001 on the harmonization of accounting practices. We find that the Chinese Government's 2001 compulsory harmonization policy has made a significant contribution to reducing the differences between Chinese GAAP-based earnings and IFRS-based earnings for many line items. The decline of earnings differences is because of the firms' application of the standards rather than differences in the standards. We believe that the harmonization of accounting practices in line with IFRS can be achieved by effective enforcement of standards.

JEL Classification: M41, G34

Keywords: Chinese GAAP, IFRS, earnings difference, harmonization.

1. Introduction

In response to emerging stock markets in China and increasing demand from foreign direct investors in China, the Chinese Government conducted a series of accounting standards reforms in 1992, 1998 and 2001 with the aim of converging Chinese Generally Accepted Accounting Principles (GAAP) with International Financial Reporting Standards (IFRS), formerly known as International Accounting Standards. Of these three GAAP reforms, those undertaken in 1998 provided the most significant movement of Chinese

* We thank the editor Professor Ferdinand Gul and referees for their very useful comments on a previous draft. We also thank the discussants in the first JCAE Symposium (Hong Kong, 2006) for their insightful suggestions and invaluable discussions.

GAAP towards IFRS. Chen et al. (2002) assessed the effectiveness of the 1998 reforms on China's accounting practices and found that reported earnings under the two sets of standards after 1998 were still significantly different. They argue that the lack of an effective financial reporting infrastructure and the low quality of external audit in China may have resulted in managerial accounting decisions that undermined the effectiveness of regulatory reform in harmonizing accounting practices.

This paper investigates the influence of the financial reporting infrastructure, in particular regulatory enforcement, on the harmonization of China's accounting practices. It investigates the impact of a special Government policy implemented by the Chinese Securities Regulatory Commission (CSRC) in 2001 that prohibited a firm's management from providing different accounting estimates based on its Chinese GAAP-based reports and its IFRS-based reports for the same business transactions and events. It also highlights the significance of regulatory enforcement and the financial reporting infrastructure in the harmonization of accounting practices.

We adopt a line-item analysis approach to investigate the line-item earnings differences between Chinese GAAP-based and IFRS-based financial statements from 1999 to 2003. Our findings show that there is a clear decline in many line-item earnings differences over the investigation period which was a result of the CSRC 2001 policy rather than the differences in standards. This policy effectively curbed earnings management opportunism in the application of Chinese accounting standards. We believe that only when effective enforcement supports the implementation of accounting standards can a nation expect to realize the harmonization of its accounting practices with IFRS.

The remainder of this paper consists of the following four sections. Section 2 reviews the prior literature and Chinese accounting reforms in 2001. Section 3 introduces the research design, data collection and sample descriptive statistics. Section 4 presents the results and discussion. Section 5 concludes the study.

2. Review of Literature and Institutional Background

2.1. Prior literature

Research has shown that there are increasing similarities between IFRS and national accounting standards in both developed and developing nations over the last three decades (Nair and Frank, 1981; Douppnik, 1987; Street and Gray, 1999; Street, 2003). However, empirical evidence suggests that the International Accounting Standards Board (IASB) has had little effect on harmonizing accounting practices by adopting similar accounting standards (Evans and Taylor, 1982; Van der Tas, 1988; Emenyonu and Gray, 1992, 1996; Hermann and Thomas, 1995; Archer et al., 1995; Tower et al., 1999; Canibano and Mora, 2000). The researchers argue that the level of harmony does not depend on the presence of a uniform method but rather on the adoption of the same accounting process under the same circumstances (McLeay, 1999). Differences in financial reporting infrastructure may lead to non-comparable accounting figures despite similar accounting standards (Radebaugh and Gray, 1997; Schultz and Lopez, 2001). Financial reporting quality is an endogenous function of market demands and political influences that are specific to each country (Ball et al., 2003).

Download English Version:

<https://daneshyari.com/en/article/5093000>

Download Persian Version:

<https://daneshyari.com/article/5093000>

[Daneshyari.com](https://daneshyari.com)