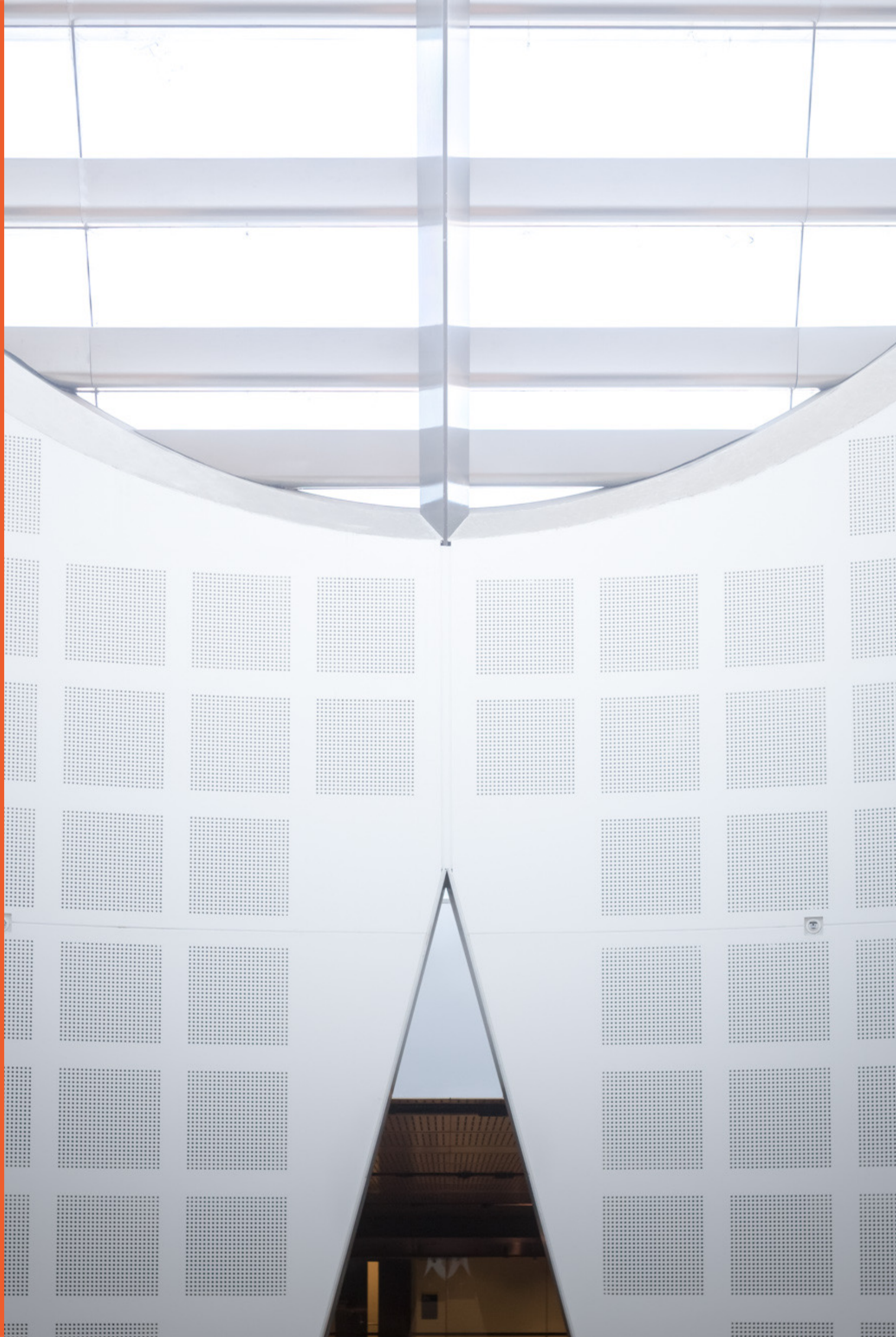
ACCT 6002

China, Japan and Germany



THE UNIVERSITY OF SYDNEY

Causes of international difference

- **Text readings:**
- *Comparative International Accounting*: Chapters 12, 15 and16

- **Academic paper, on Canvas:** Xiao, J., Weetman, P. and Sun, M. (2004), 'Political Influence and Coexistence of a Uniform Accounting System and Accounting Standards', *Abacus*, Vol. 40 (2), 2004.

- **Self-Study Questions:** See Canvas for instructions

Learning objectives

After this week's studies, you should be able to:

- explain why one might study China, Japan and Germany together;
- outline the two main types of legal system to be found in the world and how these are related to accounting differences;
- illustrate the linkages between taxation and financial reporting, using specific detailed examples from Germany;
- explain the positions of China, Japan and Germany in previous classifications;
- discuss the cultural and other constraints on harmonization, as applied to these three countries.

China, Japan and Germany

- World's three largest economies after the US
- Roman law in Japan and Germany; something similar in China
- Charts of accounts (a German inve
  standardised cost accounting); add
  uniform accounting
- Importance of financing from bank
  and the state (i.e. small influence of equity-outsiders)
- Tax influence important

Japan imported German style commercial law from the 1860s

China did this in the early 20th Century

Major Stock Exchanges, August 2018

Country	Exchange	Domestic listed companies	Market cap. of domestic equities ($bn)	Market capitalization as % of NYSE
Europe				
-	Euronext	1,078	4,370	18
Germany	Deutsche Börse	460	2,147	9
Switzerland	SIX	235	1,611	7
United Kingdom	London	2,079	4,147	17
The Americas				
Canada	Toronto	3,316	2,297	9
United States	NASDAQ	2,608	11,971	49
	New York	1,780	24,239	100
Asia-Pacific				
China	Hong Kong	2,107	4,104	17
	Shanghai	1,440	4,254	18
	Shenzhen	2,117	2,709	11
India	Bombay	5,068	2,248	9
Japan	Tokyo	3,630	6,050	25
S. Korea	Seoul	2,149	1,642	7
Australia	Australian	2,151	1,449	6

Public Accountancy Bodies, 2018

Country	*Body*	*Founded*	*Size 000s*
US	AICPA	1887	431
Canada	CICA	1880	210
UK/IRL	ICAS	1854	22
	ICAEW	1870	149
	CA Ireland	1888	27
	ACCA	1891	208
Australia	CPA	1886	164
	CAANZ	1885	117
Netherlands	NIVRA	1895	21
France	OEC	1942	19
Germany	IDW	1932	13
Japan	JICPA	1948	29

Note

- Note the vast numbers of accountants in Australia compared to Japan
- This would be even more extraordinary when adjusted for size of population
- Note the early founding dates in Australia (new country) compared to Germany or Japan (old countries)
- China’s body (state-run) is recent

JAPAN

Japan

- Third largest economy
- An island nation, but outside influence on accounting for over 100 years:
  - First from Europe and then from the US
- IASB has become a key factor in the recent development of Japanese accounting

Japan over time

- Industrialisation began in 1868, the government encouraged the growth of industry
- Up to WW2, economy was controlled by "industrial-political consortia" which include banks, but was fairly closed and without much outside equity involvement
- After WW2 Japan became a world economic superpower
- Suffered significant losses in the early 1990s, leading to a lot of restructuring. Including in accounting
- There are now only a small amount of Japanese companies amongst the world's largest
- Government has significant influence over accounting through:
  - the Companies Act (German influence);
  - the Financial Instruments and Exchange Act (US influence);
  - and tax law

Japanese Regulation in more detail

- 1. Companies Act 2005:
  - Roots in German commercial Code
  - Protection of creditors is considered at least as important as the protection of shareholders
  - Accounting emphasises prudent asset valuation rather than income measurement
  - Enforces audit for companies with capital over 500M yen or liabilities of over 20 billion yen
- 2. Financial Instruments and Exchange Act 2006:
  - Measurement and disclosure requirements more than Companies Act
  - Administered by the Financial Services Agency (FSA)
  - Tend to focus on income measurement and shareholders than on asset valuation and creditor protection
- Publicly traded firms are subject to both and have to prepare two sets of accounts: one for shareholders (companies Act) and one for filing, in accordance with the Securities Act.
- Net income will be the same, except there are more disclosure under the Securities Law

Japanese Regulation in more detail

- 3. Tax rules and laws:
  - These have a significant impact
  - As in many European countries, certain deductions and deferrals of income are only permitted for tax purposes if they are reflected in the company's statutory accounts
  - It is often more detailed and precise as to what is and is not allowed in terms of things such as depreciation

Japan and IFRS

- Japanese firms have traditionally relied on debt rather than equity as finance
- Japanese accounting profession has had relatively little influence on financial reporting
- Japanese Institute of Certified Accountants was a founding member of the IASC
- 2001: Japan established a private-sector standard setter (ASBJapan) to liaise with the IASB
- Convergence with IFRS began in 2005
- 2009: IFRS allowed for consolidated statements of listed companies (now common)
- Proposal for compulsory adoption of IFRS, but abandoned because the US abandoned it

Japan: four GAAPs

- In addition to convergence of Japanese GAAP with IFRS, and the permission to use IFRS, there is now “Japanese modifications of IFRS”
- US GAAP is also allowed for some companies
- So, there are four GAAPs for listed companies

Table 12.1
Standards of the ASB Japan (August 2019)

Statement	
1	Treasury shares and appropriation of legal reserves
2	Earnings per share
3	Amendment to standard on retirement benefits
4	Directors' bonuses
5	Presentation of net assets
6	Statement of changes in net assets
7	Business divestitures
8	Share-based payments
9	Measurement of inventories
10	Financial instruments
11	Related party disclosures
12	Quarterly financial reporting
13	Lease transactions
14	Amendment to standard on retirement benefits
15	Construction contracts
16	Revised standard for equity method of accounting for investments
17	Disclosures about segments of an enterprise and related information
18	Asset retirement obligations
19	Partial amendments to standard on retirement benefits
20	Disclosures about fair value of investment and rental property
21	Business combinations
22	Consolidated financial statements
23	Partial amendments to standard on research and development costs
24	Accounting changes and error corrections
25	Presentation of comprehensive income
26	Retirement benefits
27	Current income taxes
28	Amendments to standard on tax effect accounting
29	Revenue recognition
30	Fair value measurement

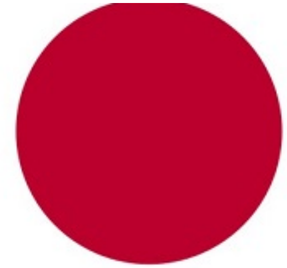
Source: Prepared by the author.

Table 12.2
Adoption of IFRS by Japanese companies

	March 2015	June 2016	June 2018
Number of companies adopting IFRS	75	112	204
% of capitalisation of Tokyo Exchange	18	29	34

Source: Prepared by the author from announcements by the Financial Services Agency of Japan.

Japan



Extent of IFRS application	Status	Additional Information
IFRS Standards are required for domestic public companies		
IFRS Standards are permitted but not required for domestic public companies	✓	IFRS Standards are one of four permitted financial reporting frameworks. The others are Japanese GAAP, Japan's Modified International Standards (JMIS), and US GAAP.
IFRS Standards are required or permitted for listings by foreign companies	✓	Permitted.
The IFRS for SMEs Standard is required or permitted		No.
The IFRS for SMEs Standard is under consideration		No.

JURISDICTION PROFILE

Some Japanese differences from IFRS

- Tangible assets :
  - Borrowing costs on self constructed assets are not capitalised whereas they must be under IFRS or US GAAP
  - Revaluations are not allowed (apart from land), which is in line with US and German practice but not IFRS
- Depreciation:
  - Japanese often use reducing balance method (%), most use rates prescribed in tax law
- Impairment:
  - Impairment test uses undiscounted cash flows; and reversals are not allowed (both like US)

More differences from IFRS

- Intangibles:
  - R & D costs are expensed, like US GAAP (not like IFRS, under which development costs must be capitalised if they meet the criteria)
- Legal reserve:
  - Companies Act requires an amount of at least 10% of its dividends to be put into a reserve, until the reserve equals 25% of capital stock. It cannot be distributed, and reflects concerns for creditors.
- See longer list: Table 12.3

Table 12.3
Some major Japan/IFRS differences, 2019

Topic		Japan	IFRS
1	PPE and investment property	Historical cost basis	Fair value allowed
2	Leases capitalised?	Finance leases	All leases
3	Borrowing costs on construction	Generally expensed	Capitalised
4	Development costs	Expensed (except software)	Some must be capitalised
5	Pre-opening costs	Can be capitalised	Must be expensed
6	Intangible amortisation	All amortised	Indefinite-life not amortised
7	Goodwill	Amortised up to 20 years	Annually impaired
8	Impairment test	Based on undiscounted cash flows	No test; measured using discounted cash flows
9	Impairment reversals	Not allowed	Required when appropriate
10	Inventory write-downs	Can be treated as permanent	Reversed when appropriate
11	Unlisted shares	At cost	At fair value
12	Provisions	Can be made when no obligation; generally not discounted	Only when obligation; discounted
13	Proposed dividends	Can be accrued	Not accrued
14	Convertible debentures	Generally treated as debt	Split into equity and debt
15	Long-term contracts	Restricted taking of revenue over time	% of completion method
16	Extraordinary items	Wide definition	Not allowed
17	Discontinued operations	Not disclosed	Disclosed in detail
18	Temporarily held subsidiaries	Excluded from consolidation	Consolidated

Table 12.4
Reconciliation of equity by Sumitomo Chemical at 31 March 2017 (¥ billions)

Equity under J GAAP	1,162
Current assets	(90)
Fixed assets	117
Current liabilities	(50)
Long-term liabilities	(23)
Equity under IFRS	1,116

Source: Prepared by the authors from published financial statements.

- https://www.icaew.com/en/technical/by-country/asia/japan/accounting-in-japan

CHINA

How Accounting Is Different in China - Paul Gillis, the Guru of Chinese Accounting

https://www.youtube.com/watch?v=aF2q7D4JwLQ

China

- Like Japan, a long history of centralised imperial control
- Also, like Japan, China borrowed codified commercial law from Western Europe
- But, unlike Japan, China introduced a Soviet-style uniform accounting system
- More recently, China has substituted one European-invented economic system (communism) for another (stock market capitalism)
- This led to huge changes in the purpose and operations of accounting
- IASB has been of importance, especially since China adopted new standard for listed companies that are approximately based on IFRS

China

- 1992:
  - Ministry of Finance issues four accounting regulations
  - Aimed at attracting foreign investment
  - Regulations were patchy
  - The Chinese Securities Regulatory Commission - a capital market regulator - was established (similar to the SEC)

After 1992

- 1992 onwards:
  - World Bank funded accountancy reform
  - 30 EDs issues between 1994 and 1996. Closely in line with the IASC
  - China joined the IASC in 1997
  - China Accounting Standards Committee was founded in 1998 (academics, members of accounting firms, and government experts)
  - 16 standards issued up to 2005
  - 2006 a new set of ASBEs were issued largely in line with IFRS

China

Extent of IFRS application	Status	Additional Information
IFRS Standards are required for domestic public companies		China's national standards are substantially converged with IFRS Standards, and China has committed to adopt IFRS Standards for reporting by at least some domestic companies although there is no timetable for completion of the process. Chinese companies representing more than 30 per cent of the total market capitalisation of the domestic market produce IFRS-compliant financial statements as a result of their dual listings in Hong Kong and other international markets.
IFRS Standards are permitted but not required for domestic public companies		
IFRS Standards are required or permitted for listings by foreign companies		Foreign companies do not trade currently in Chinese securities markets. Therefore, there is no relevant regulation on whether those companies would be permitted to use IFRS Standards.
The IFRS for SMEs Standard is required or permitted		No.
The IFRS for SMEs Standard is under consideration		No.

Some Chinese differences from IFRS

- Tangible assets :
  - Revaluations are not allowed, which is in line with US, Germany and Japan but not IFRS
- Impairment:
  - Reversals are not allowed (like US and Japan but not IFRS)

Table 12.5
Some ways in which Chinese rules differ from IFRS

Incompatibilities

- ASBE 8 prohibits the reversal of all impairment losses (like US GAAP but unlike IAS 36);
- ASBE 5 generally requires measurement at cost for biological assets unless there is convincing evidence that fair value is reliable (whereas IAS 41 presumes that fair value is reliable).

Removal of options

- ASBE 4, ASBE 6 and ASBE 27 do not allow an option of fair value measurement for tangible and intangible non-current assets (like US GAAP but unlike IASs 16 and 38 and IFRS 6);
- ASBE 30 requires the income statement to be presented by function (whereas IAS 1 and US GAAP allow it by nature);
- ASBE 31 does not allow the indirect method for the cash flow statement (unlike IAS 7 or US GAAP).

Table 12.6
Differences between ASBE and IFRS for China Eastern Airlines, 2009 (millions of renminbi)

	Earnings	Equity*
Under ASBE	540	3,104
Pension obligation	(334)	(1,850)
Correcting valuation of land use rights	8	(360)
Correcting asset depreciable lives	(65)	168
Other	(8)	147
Deferred tax on the above	28	26
Under IFRS	169	1,235

Note: *Excluding non-controlling interests.

Source: Prepared by the authors from published financial statements.

Table 12.7
Differences between ASBE and IFRS for China Eastern Airlines, 2016 (millions of renminbi)

	Earnings	Equity*
Under ASBE	4,408	47,180
Correcting depreciation expense	(10)	31
Intangibles on business combination	–	2,242
Other	–	(3)
Under IFRS	4,498	49,450

Note: *Excluding non-controlling interests.

Source: Prepared by the authors from published financial statements.

Table 12.8
Differences between ASBE and Hong Kong IFRS for Beijing North Star, 2017 (millions of renminbi)

	Earnings	Equity*
Under ASBE	1,140.4	12,599.0
Reversal of investment property depreciation	138.4	1,530.0
Adjustment to fair value for investment properties	111.0	4,261.2
Under Hong Kong IFRS	1,389.8	18,390.2

Note: *Excluding non-controlling interests.

Source: Prepared by the author from the company's 2017 Annual Report, p. 168.

Journal article

- Xiao, Weetman and Sun (2004) “Political Influence and Coexistence of a uniform Accounting system and accounting standards: Recent developments in China”, *Abacus*
  - Contributes to the literature on classification
  - Political influences affect the rate of transition towards full implementation of international accounting standards
  - They argue that (at the time) China renewed their Unified Accounting System, while also issuing IAS based standards because the economy was transitioning, there was strong government influence, the equity market was developing and the accounting traditions within China were slow to be reformed.
  - The government was actively trying to ensure stability as they transitioned towards more market oriented forms of accounting, something that also needed to make sense within the context of socialism

Xiao et al (2004)

- History of accounting in China:
  - 1950s UAS was imported from the Soviet Union to support central planning.
  - It was eradicated as part of the Great Leap Forward
  - Accounting education ceased during the cultural revolution between 1965-1975
  - In 1978, ‘open door’ economic reform policies emerged
  - Ministry of Finance regained control of accounting regulation and restored UAS
  - In 1988 a project group was established to study accounting standards
  - In 1991 stock exchanges were established.
  - 1992 ASBE (Accounting Standards for Business Enterprise) were issued
  - 1993 MoF worked with the World Bank to develop standards
  - 1999 Accounting Law amended to stress the importance of ‘true and complete’
  - 2006: amended version of IFRS required for consolidated statement of listed companies

The Big 4 Accounting Firms of China Are Not Who You Think - Paul Gillis, Peking U

https://www.youtube.com/watch?v=iml_ZN7IsfA

- https://www.icaew.com/en/technical/by-country/greater-china/china/accounting-in-china

GERMANY

Some Areas of Potential Tax Connection

1. Depreciation
2. Valuation of fixed assets
3. Bad debt allowances
4. Long-term contracts
5. Inventory valuation
6. Lease capitalisation
7. Pension expenses
8. Unsettled foreign currency balances

German Accounting and Tax Law

- The oldest formal version of a strong tax linkage is in Germany
- 1872 Saxon Income Tax Law:
  - Tax accounts = Financial accounts
  - *Steuerbilanz* = *Handelsbilanz*
- This is the *Massgeblichkeitsprinzip or* 'the authoritative principle'

Volkswagen (moving from German GAAP to IFRS)

	€m
Net assets (under German law) 1.1.2000	9,811
Capitalization of development costs	3,982
Amended useful lives and depreciation methods of tangible and intangible assets	3,483
Capitalization of overheads in inventories	653
Differing treatment of leasing contracts as lessor	1,962
Differing valuation of financial instruments	897
Effect of deferred taxes	- 1,345
Elimination of special items	262
Amended valuation of pension and similar obligations	- 633
Amended accounting treatment of provisions	2,022
Classification of minority interests not as part of equity	- 197
Other changes	21
Equity (under IFRS) 1.1.2000	20,918

Example: Bad Debt Allowances

(i) Why am I calling them “allowances” and not “provisions”?

– Provision is a ‘liability of uncertain timing or amount’ (AASB 137), so these cannot be provisions. ‘Allowances’ is a US word, but will do

(ii) What is the proper word in IFRS?

– Impairment of receivables

(iii) Are increases in bad debt allowances tax deductible in the Australia, UK or US?

– Not if a % is used, but if particular debtors are shown to be bad.

(iv) Germany? Japan?

– Yes, but the amounts are controlled by the tax inspector

Example: LIFO

Allowed

Germany, Italy, France (consolidated), US, Japan

Banned

UK, France (unconsolidated), China, IFRS

Capitalisation of leases by lessees

Required for all leases

IFRS, US

Required for finance leases

IFRS for SMEs, UK, Germany (but defined in tax law), Japan

Allowed

France (finance leases in consolidated accounts)

Banned

France (unconsolidated), Italy

German differences from IFRS

- See above on depreciation, leases, etc
- See Table 16.3

Table 16.3
Some differences between German GAAP and IFRS for individual company financial statements

Topic	Germany	IFRS
1 PPE	Cost or lower	Can be held at fair value
2 Goodwill	Amortised	Impaired
3 Contracts	Usually completed contract	Revenue taken over time under some circumstances
4 Marketable securities	Lower of cost and market (except banks)	Fair value
5 Development costs	Permission to capitalise	Requirement to capitalise some
6 Derivatives	Not recognised	Fair value
7 Inventories	LIFO allowed	LIFO not allowed
8 Interest on construction	Expensed or capitalised	Capitalised
9 Leases	Some capitalised by lessees (following tax rules)	Capitalised by lessees
10 Provisions for repairs	Made when incurred in the first 3 months of the following year	Only when obligation
11 Employee benefit provisions	10-year average rate; no special treatment of actuarial gains/losses	Market discount rate; Actuarial gains/losses taken to OCI
12 Deferred tax assets	Option to recognise	Must be recognised when probable
13 Policy changes and correction of errors	Through income	Restatement
14 Cash flow statements	Not required	Required

Table 16.4
Reconciliations by BASF from German to US rules for 2004 (€m)

	Income	Equity
As reported income under German GAAP	1,883.0	15,765.0
Adjustments required to conform with US GAAP		
Capitalisation of interest	(4.5)	472.7
Capitalisation of software developed for internal use	(53.5)	128.3
Accounting for pensions	41.0	924.3
Accounting for provisions	(8.1)	244.4
Accounting for derivatives and long-term foreign currency items	194.5	3.2
Valuation of securities at market values	6.8	191.5
Valuation adjustments relating to companies accounted for under the equity method	(161.6)	39.0
Inventory valuation	(3.4)	18.9
Reversal of goodwill amortisation	148.7	469.5
Other adjustments	29.8	58.6
Deferred taxes and recognition of tax effects of dividend payments	(210.4)	(810.8)
Minority interests	0.5	(345.5)
In accordance with US GAAP	1,862.8	17,159.1

Source: Adapted from the *BASF Annual Report, 2004*, p. 92. BASF SE, Ludwigshafen, Germany.

Germany

Extent of IFRS application	Status	Additional Information
IFRS Standards are required for domestic public companies	✓	All domestic companies whose securities trade in a regulated market are required to use IFRS Standards as adopted by the EU in their consolidated financial statements.
IFRS Standards are permitted but not required for domestic public companies		
IFRS Standards are required or permitted for listings by foreign companies	✓	IFRS Standards as adopted by the EU are required in their consolidated financial statements except that a foreign company whose home jurisdiction's standards are deemed by the EU to be equivalent to IFRS Standards may use its home standards.
The IFRS for SMEs Standard is required or permitted		No.
The IFRS for SMEs Standard is under consideration		No.

- https://www.ifrs.org/use-around-the-world/use-of-ifrs-standards-by-jurisdiction/view-jurisdiction/germany/

SUMMARY FOR THE THREE COUNTRIES

Previous Classifications

- Germany and Japan were put together by Nobes (1983, 1998), and both put with the US by Frank (1980) and by Nair and Frank (1981)

- China not included

Summary: Anglo-American Influences

- Japan:
  - run by US in late 1940s: Anti-trust laws, Securities and Exchange Laws (SEL), JICPA
  - founder member of IASC, 1973
  - convergence with IASB
  - IFRS now allowed
- China:
  - rapid move to capitalism from 1978
  - World Bank grant for IAS (Deloitte), 1992+
  - HK moves from UK to IAS
  - China joins IASC (not board), 1997
  - 2006, ASBE standards close to IFRS, for listed companies

Summary: Anglo-American Influences

- Germany:
  - EU 4th Directive (1985 Act, little influence)
  - 7th Directive (1985 Act, some influence)
  - 1990 re-unification and the need to raise finance
  - 1993 Daimler uses US GAAP
  - 1994 Bayer, Hoechst use IAS
  - 1998 Law allows IAS for listed/consolidated
  - EU requires IFRS for consolidated statements from 2005

Cultural, Legal, Tax Problems

- Japan:
  - Commercial Code controls accounting
  - Listed/consolidated do Securities Exchange Law accounts separately
- Germany:
  - Commercial Code (HGB) continues for unconsolidated statements
  - IFRS for consolidated statements only
- China:
  - Tension between old chart of accounts and new IFRS principles
- **All three countries still have two types of accounting**