Chinese Corporate Finance and International Trade Disputes

[30 May. 2008 Issues 11]

As announced in February of last year (2/15/2006), with the onset of the year new the 1,200 companies listed on the Shanghai and Shenzhen stock exchanges have begun to employ the new Chinese Accounting Standards (CAS). The newly implemented metrics are composed of 39 specific standards that have been designed to approach convergence with the International Financial Reporting Standards (IFRS), considered the benchmark in most developed markets .

Among many other interested parties, US business, has consistently advocated a greater degree of transparency into the financial workings of Chinese companies. The ambitiously planned transition was initially greeted with enthusiasm and "widely viewed as a commitment to transparent financial reporting" as well as a further endorsement of market liberalization. CAS adoption should, if properly executed, make it significantly easier for US businesses to outsource, acquire and otherwise partner with financially healthy Chinese firms. Further, while Chinese companies scramble to properly integrate the new standards into their business operations - and with that report perhaps some unattractive figures - US businesses in China may well emerge looking comparatively stronger next to their Chinese competitors . Similarly, a small degree of market instability has been forecasted as another possible consequence of CAS adoption if more stringent standards compel Chinese firms to disclose unsavory information they were previously able to obscure, conceivably leading to corporate setbacks, scandals or even failures.

Inexperienced, overwhelmed and understaffed Chinese accounting firms and internal corporate controllers will likely enlist the help of more versed western firms to navigate and fulfill CAS's new requirements and the sector is poised to benefit . PRC Vice Minister of Finance Jun Wang reaffirmed in a speech in late last year his country's need and desire to learn from their counterparts abroad, "[by] using the education and training system of overseas professional organizations, [and] helping domestic professional talents acquire oversees practicing qualifications" . US accounting firms should enjoy a multitude of new opportunities in china's financial services sector.

As with nearly all meaningful policy reforms, practice and implementation will present the largest hurdles and likely dictate the extent of success. Many in the accounting arena were surprised by the little time allotted for compliance and the un-phased manner of the convergence and are thus understandably skeptical of company comprehension and compliance . PricewaterhouseCoopers notes that other countries (Japan and the United Kingdom) converged in a series of phases and even then underestimated the magnitude of the change and the effort it required . Chinese media outlets are, in fact, already predicting some confusion and instability . In addition, as accurately prepared accounts might well unearth unsightly corporate information, the protection afforded to honest accountants as well as the degree to which accuracy is embraced as paramount, will both be critical variables to which skepticism, reasonably, abounds . While all State-owed enterprises (SOEs) plan to have fully adopted the new standards by the end of 2008, 24 of the country's largest SOEs (Among them: China National Petroleum Corporation (CNPC), China Petrochemical Corporation (Sinopec), Baosteel Group, AirChina, China Mobile) were to have joined the listed companies in compliance from 2007 . CAS, while approaching convergence, still contains notable disparities, especially with respect to China's massive State-owned sector. Differences relate to "the accounting for certain government grants; and…related party disclosures between State-owned enterprises that have no direct investment relationship" . Because of the abundance of 'related party' transactions among SOEs there are admittedly structural impediments to their accurate recording; nevertheless, these discrepancies still seem to possess an obfuscating potential that runs counter to the spirit of convergence.

The challenges that await this latest effort towards international integration, namely inherent difficulties presented by SOEs, otherwise shallow financial markets and a questionable willingness and ability to accurate disclosure are certainly equally as significant as the ostensible benefits. Future developments will surely continue this confrontation of liberalizing and constricting forces.