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# Progress of and Obstacles to IFRS Implementation in an Emerging Economy: Auditors' Perspective*

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## Abstract

Successful implementation of the International Financial Reporting Standards (IFRS) is particularly challenging in emerging economies where IFRS-compatible institutions are underdeveloped. In this study, we conduct a survey and in-depth interviews with experienced auditors in China, the largest emerging economy in the world, to advance our understanding of the extent of the success of IFRS implementation and the obstacles that arise during the IFRS implementation process. Our study reveals that although the majority of the respondents agreed that the implementation of the IFRS has achieved its goals, including improving reporting quality, lowering the cost of capital, attracting more foreign investors, and promoting corporate governance performance, a substantial proportion of them remained pessimistic. Our study also identifies several factors that adversely affect the successful implementation of IFRS in China. Qualitative feedback from the interviews provides further insights into how these factors affect IFRS implementation. Our findings provide implications for other emerging economies with similar institutional backgrounds to China.

***Keywords***: International Financial Reporting Standards, China, Survey

***JEL classification***: M41, M42

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# 在一个发展中国家实施国际会计准则的进度和困难：审计师的视角


## 摘要

在一个发展中国家成功实施国际会计准则极具挑战，因为在这些国家中和国际会计准则相容的制度并不完善。在这个研究中，我们对中国—这个世界上最大的发展中国家—的富有经验的审计师进行问卷调查和面谈，以深入理解国际会计准则实施的进度和困难。我们的研究显示，虽然大多数的受访审计师同意中国实施国际会计准则已达成包括提高财务报告质量、降低资本成本、吸引更多外国资本，和提升公司治理表现的目标，仍有相当一部分受访者对此表示悲观。我们的研究也确定了许多影响中国成功实施国际会计准则的不利因素。我们从面谈中获取的质性反馈也进一步提供了关于这些因素如何影响国际会计准则实施的洞见。我们的研究为和中国有类似制度背景的发展中国家提供了借鉴。

## I. Introduction

With the increased globalisation of business, a strong interest in the international convergence of financial reporting has emerged among financial information users and regulators around the world. The International Accounting Standards Board (IASB) and its predecessor organisation, the International Accounting Standards Committee (IASC), have made a concerted effort to set international standards and promote their application globally. As of September 2015, around 116 jurisdictions had adopted the International Financial Reporting Standards (IFRS).[4] Nevertheless, prior studies have shown that IFRS implementation has not necessarily achieved the desired goals, particularly in countries with weak investor protection.[5] The uneven implementation of IFRS "curtails the ability of uniform standards to reduce information costs and information risk" (Ball, 2006). However, with the exception of studies in Australia (Morris *et al.*, 2014) and Europe (Larson and Street, 2004; Jermakowicz and Gornik-Tomaszewski, 2006), the issue of IFRS implementation has not attracted sufficient research attention (Ball, 2006). This issue is particularly salient in emerging economies; however, few survey-based studies have been conducted to explore the underlying obstacles in the adoption process. We were motivated to conduct a survey in China, the largest emerging economy in the world where IFRS-compatible institutions are underdeveloped, to shed some light on the issue.

Like many other emerging economies, China's road to convergence with IFRS has been bumpy (Tang, 2000). The accounting system experienced dramatic changes before it converged with IFRS. When the People's Republic of China was established in 1949, a set of standardised accounts was created to integrate economic information for the purpose of economic planning. In the late 1970s, China began to implement dramatic economic reform to build up a socialist market economy. Those economic reforms and the establishment of stock exchanges created a demand for international accounting standards. The first step towards convergence with international accounting standards occurred in 1992. The most significant change after 1992 was made in 2006, when the Ministry of Finance (MOF) promulgated the new *China Accounting Standards* (CAS) and required all listing firms to adopt them effective 1 January 2007. The CAS consist of one basic standard, 38 specific standards, and adoption guidance, representing the most comprehensive set of accounting standards in China to substantially converge with IFRS.

Has China's convergence with IFRS achieved the desired goals? The extant empirical evidence is at best mixed (e.g. Lee *et al.*, 2013; DeFond *et al.*, 2014; He *et al.*, 2012). Institutional incompatibility with IFRS has been identified as one important factor impeding

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4 http://www.ifrs.org/Features/Pages/Global-reach-of-IFRS-is-expanding.aspx.

5 Many prior studies show that firms experience improved earnings quality (Barth *et al.*, 2008; Landsman *et al.*, 2012; Clarkson *et al.*, 2011), increased comparability of financial reporting (DeFond *et al.*, 2011), more foreign investment (DeFond *et al.*, 2011; Gordon *et al.*, 2012), and lower cost of equity (Daske *et al.*, 2008; Li, 2010) after the adoption of IFRS.

successful implementation of the standards,[6] leading to the question of which institutional factors are responsible. Given the mixed results and China's unique institutions, our study supplements prior archival studies by (1) assessing the extent of the success of IFRS adoption in China and (2) identifying the obstacles, particularly the institutional obstacles, during the IFRS implementation process in China after 2007. Although our study is based on China, it is also relevant to other emerging economies planning to implement IFRS or at an early stage of implementation (Ding and Su, 2008).

In 2015, after around eight years of IFRS adoption in China, we conducted a survey to investigate the extent of the success of IFRS adoption in China and obstacles in the adoption process. We used the survey method because this approach could better uncover institutional issues and avoid the potential problems of inferring intent from statistical methods based on archival data (Dichev *et al.*, 2013). Our questionnaire incorporated some issues common in the process of IFRS implementation outside China and issues related to China's unique institutions. We used a stratified sampling method because China's audit market is highly segmented. We distributed our questionnaire to three categories of auditor and asked at least one senior staff member from each auditor in China to coordinate the survey. We received 176 valid responses from practising auditors[7] with at least three years' audit experience. To obtain more insights from the auditors, we conducted follow-up interviews after the survey.

On the basis of the survey and the interviews, we offer several findings. In general, our results reveal that the majority of the respondents agreed that the adoption of the CAS has achieved its desired goals, including improving reporting quality, lowering the cost of capital, attracting more foreign investors, and promoting corporate governance performance. However, a significant number of respondents questioned the extent of this success. The qualitative feedback revealed that the success of IFRS implementation should be interpreted with caution.

Our results show the following obstacles in the implementation process. First, we find that the complex nature of the CAS, the lack of implementation guidance, and the lack of a uniform interpretation of the CAS hinder the effective adoption of IFRS in China. The respondents identified some standards that are too complicated for accountants. Confirming prior discussions on fair value (FV) accounting (He *et al.*, 2012), the results reveal that FV is the weakest area of the CAS. Additionally, our results suggest that understandable and clear guidance is particularly important in China because the majority of accountants lack sufficient IFRS training.

Second, client characteristics have a significant influence on the effectiveness of IFRS

6 Like many other emerging economies, China's current institutions are incompatible with IFRS as these standards are based on the microeconomic, shareholder-oriented, judgment-based model of financial reporting that tends to prevail in culturally self-sufficient countries (Tyrrall *et al.*, 2007).

7 The sample size is comparable to prior studies: for example, 112 responses in Jermakowicz and Gornik-Tomaszewski (2006).

implementation in China. The concentrated ownership structure reduces the demand for high quality financial reporting, and the respondents identified weak commitment at the top management level as one of the primary barriers to implementation. In addition, ineffective governance at the board level means that successful IFRS implementation cannot be assured. In addition to top management influences, the mindset of accountants and their insufficient IFRS training are two further impeding factors. Our results show that China's accountants have not changed their mindset towards IFRS in the transition from rules-based accounting standards. Our findings complement prior archival studies by showing that both corporate governance and accountants' characteristics affect IFRS adoption in China.

Third, China's current institutions also adversely affect IFRS implementation. Our survey reveals that improper government intervention, including subsidising firms and pressuring local auditors, weakens successful IFRS implementation. The rigid tax accounting system also causes accountants to deviate from IFRS objectives. Our results also show that the lack of a vibrant market for FV accounting and an underdeveloped capital market impair IFRS implementation by affecting FV accounting. Taken together, the results highlight the role of various institutional factors in the IFRS adoption process in China.

Finally, our results show that audit-related characteristics, including capacity, independence, remuneration, and enforcement by an auditing regulatory body, do not impede successful implementation of IFRS in China. In general, the Big 4 have fewer problems than their local counterparts. However, we caution that reporting bias may arise from the respondents' self-serving motives.

Our study makes several contributions to the literature. First, to the best of our knowledge, it is the first study based on a survey to systematically investigate IFRS implementation issues in China. We supplement prior studies in Europe and Australia, where institutions are well developed (e.g. Larson and Street, 2004; Jermakowicz and Gornik-Tomaszewski, 2006; Morris *et al.*, 2014), and provide implications for other emerging economies with similar institutional backgrounds to China. Our study also complements prior archival studies (e.g. Lee *et al.*, 2013; DeFond *et al.*, 2014; He *et al.*, 2012) and provides additional insights from auditors. In this regard, we answer Ball's (2006) call to investigate IFRS implementation issues that relate to the IASB's objective (i.e. to take account of the special needs of emerging economies adopting IFRS). Second, our study constitutes a novel and more comprehensive framework of IFRS implementation issues.[8] This framework can be applied to subsequent similar studies, such as studies on the implementation of IFRS in SMEs, which is an important emerging issue. Regulators may also use this framework when considering whether to adopt accounting standards. Future researchers can extend our approach when conducting similar studies in other countries.

[8] Our framework consists of various layers of factors, including the standards, clients, audits, and institutions. Prior studies conducted in Europe and Australia have not taken account of all these factors in their frameworks, probably because the institutions are not relevant in these regions.

Finally, our findings, which identify the problems with IFRS implementation in the world's largest emerging economy, have implications for investors who have an interest in investing in the China stock market.

Despite these contributions, our study is still subject to some common limitations of a survey-based study. First, our study is based on responses from auditors as auditors possess rich experiences in IFRS implementation. As the IFRS implementation process is rather complex and requires the involvement of multiple parties, our study based on auditors' responses needs more corroborative evidence from other parties. Second, we caution that auditors' self-serving incentives may bias our inferences. Due to these limitations, we call for future studies to further examine whether IFRS implementation in China has been successful by overcoming the limitations.

The remainder of this paper proceeds as follows. In Section II, we provide the background to our study and review previous research, and in Section III, we describe our survey and methodology. Section IV reports the findings, and Section V concludes the paper.

## II. Background and Literature Review

### 2.1 China's Progress towards Convergence with IFRS

In 1978, China began to carry out economic reform with the aim of transforming a Soviet-style planned economy to a socialist market economy. For firms, the goal of the reform was to dismantle China's entirely state-owned economy and replace it with a mixed ownership model and to encourage private and foreign capital to hold ownership in Chinese companies. The creation of the Shanghai and Shenzhen stock exchanges in the early 1990s was another milestone in the move towards a socialist market economy. With the transformation of ownership reform and the creation of stock markets, the demand for quality financial reporting intensified the development of China's accounting standards.

Since the 1990s, China's accounting system has undergone at least four progressive waves of reform to better align with international accounting standards. In 1992, the MOF promulgated the *Enterprise Basic Accounting Standards* (EBAS), which represented a remarkable milestone in accounting reform in China. The EBAS provided the first conceptual framework for China's accounting standards (Davision *et al.*, 1996). In 1998, the MOF issued the *Accounting System for Joint Stock Limited Enterprises* (ASJSLE) to replace the EBAS and eliminate the discrepancies between Chinese accounting standards and international accounting standards. In 2001, the MOF promulgated the *Accounting System for Business Enterprises* (2001 Accounting System) to replace the ASJSLE. The 2001 Accounting System was another important move toward convergence with IFRS (Pacter and

Yuen, 2001). Several accounting standards[9] were modified to further align Chinese accounting standards with international accounting standards. However, prior to the implementation of IFRS in China in 2006, there was little evidence on whether the harmonisation of accounting standards led to harmonised accounting practices and comparable financial reports (Chen *et al.*, 2002). The accounting standards prior to 2006 have been criticised for being "highly prescriptive and largely rules-based" (Ho *et al.*, 2015).

As mentioned above, the most significant move towards convergence with IFRS after 1992 was made in 2006 with the introduction of the CAS and the requirement for all listing firms to adopt the new standards effective 1 January 2007. Consisting of one basic standard, 38 specific standards, and adoption guidance, the CAS is a comprehensive set of accounting standards that substantially converge with IFRS. To facilitate better implementation of the CAS, some interpretations of the standards were issued in 2007 and 2008. An important feature of the CAS is the widespread use of the FV measurement in accounting practices which requires accountants to exercise their professional judgment rather than blindly follow the rules specified in the preceding standards (Peng and Bewley, 2010). To further improve the quality of financial reporting, the China Securities Regulatory Commission (CSRC) also issued new auditing standards, similar to the standards issued by the IAAB, effective from 1 January 2007. To further increase accounting quality, China's government promulgated the *Basic Standards for Enterprise Internal Control* (BSEIC) in 2008, mandating all listed firms (on both the Shanghai and Shenzhen exchanges) to evaluate the effectiveness of their internal control systems and report auditors' opinions on the effectiveness of internal controls in annual reports.

China's efforts at convergence with IFRS have been rewarded with wide recognition of increased transparency by the international community. A report issued by the Milken Institute (2013) shows that China's transparency (opacity) ranking improved from 2001 to 2008. However, the report also reveals that China was ranked 41 out of 134 countries/regions, lower than its Asian peers (for example, Hong Kong, Japan, and Malaysia) and other emerging economies (Brazil, India, and others) (Piotroski and Wong, 2012). To date, empirical studies based on archival stock market data provide mixed results on whether the implementation of the CAS successfully increases firms' reporting quality and achieves its desired goals.[10] In regard to this, Piotroski and Wong (2012) point out that "any assessment of China's information environment should be evaluated on the basis of practices and outcomes, not standards and regulations alone."

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[9] For example, inventory and property, plant, and equipment (PPE) standards (Peng *et al.*, 2008).

[10] Lee *et al.* (2013) report increased accounting quality after the implementation of the CAS. DeFond *et al.* (2014) and He *et al.* (2012) find evidence showing that the implementation of the CAS has not achieved its desired goals.

## 2.2 Factors that Influence the Successful Implementation of IFRS in China

Despite China's efforts to improve accounting quality, the unique institutions in China still affect the production and dissemination of high-quality accounting reports. One salient feature of China's unique institutional environment is the confounding influence of the state on accounting practices. The state plays a regulatory role by promulgating accounting regulations and enforcing them. The Chinese securities regulators have set up various bright-line accounting rules and thus provided incentives for firms to manage earnings to meet these thresholds: for example, the CSRC sets ROE threshold ratios of 10% for rights issues and provides that ROE should be above 0 for firms to avoid being delisted. Empirical studies show that firms use excessive discretionary accruals to inflate earnings prior to IPOs (Aharony *et al.*, 2000) and rights offerings (Chen and Yuan, 2004) and to avoid delisting (Liu and Lu, 2007). In addition, the state controls the majority of listed firms through various ownership structures. In July 2010, the Chinese government held an average of 53% of outstanding shares in listed SOEs (Peng and Bewley, 2010). This concentrated ownership structure allows the government to intervene in firm operations by appointing key executive officers such as CEOs (Fan *et al.*, 2007). Thus, the ownership structure reduces the demand for high-quality financial reporting as a governance and monitoring device for SOEs. Ding and Su (2008) consider the ambiguity of the role played by the state as both "referee" and "player". This dual identity is likely to result in a conflict of interest and impede the objective enforcement of accounting regulations.

Although China's book-tax reporting rules have been separated since 1998, China's taxation regime could still strongly influence accounting practices. On the one hand, China's tax authority imposes high compliance requirements on firms, which may force accountants to pay more attention to compliance and therefore increase accounting quality. On the other hand, because accruals-based expenses are generally tax deductible in China, firms have strong incentives to manage earnings to save tax, leading to lower financial reporting quality.

China's social and political systems also influence financial reporting quality. Related-party transactions are prevalent in China as economic transactions are "often carried out within social and political networks" (He *et al.*, 2012). Prior studies have shown that related-party transactions are used to inflate earnings (Jian and Wong, 2010). Such transactions hamper the effective implementation of the FV accounting required by the CAS as FV accounting is based on the arm's length principle (He *et al.*, 2012).

The ownership structure in the private sector impedes the production of high-quality financial reporting. Weak investor protection arising from the underdeveloped legal and political system does not protect the interests of China's shareholders. In response, Chinese companies normally adopt a concentrated ownership structure or group business structures (Piotroski and Wong, 2012). As the controlling shareholders have incentives to exploit asymmetric information to capture private benefits at the expense of minority shareholders, they opt to make their financial reporting opaque. The prevalence of concentrated ownership structures also reduces the demand for costly high-quality accounting reports as a monitoring tool to discipline managers (Fan and Wong, 2005). Taking these factors into account, the ownership structure in the private sector discourages the production of high-quality financial reporting.

An underdeveloped auditing profession is another factor that impedes the production of high-quality financial reporting. The Chinese auditing profession is under the administration and supervision of the China Institute of Certified Public Accountants (CICPA) and the MOF. The profession experienced rapid development after the creation of capital markets. Before 1996, all audit firms were affiliated with governments, universities, or other government-sponsored agencies. To alleviate the influence of sponsoring agencies on auditors, the central government required all audit firms to disaffiliate from their sponsoring agencies. Nevertheless, the disaffiliation programme cannot completely sever the link between auditors and their ex-bureaucrats because SOE clients are economically important to them (Chan *et al.*, 2006). At local and central level, governments can still influence auditors through government-sponsored CPA supervision agencies (Piotroski and Wong, 2012). This lack of independence results in lower audit quality in China.

Accountants' qualifications are another challenge in the transition from rules-based accounting standards to new accounting standards. Accountants need to adjust to the fact that the rigid quantitative guidance of the previous standards was replaced by professional judgment in the CAS. In this regard, Ding and Su (2008) argue that Chinese accountants have received little training in how to make professional judgments in an ethical way: for example, accountants may use their own discretion and use FV accounting to manage earnings (He *et al.*, 2012).

## III. Research Design

### 3.1 Survey Instrument and Delivery

Dichev *et al.* (2013) argue that, in the context of accounting research, "surveys offer a potential way to address often intractable issues related to omitted variables and the inability to draw causal links that are endemic to large-sample archival work." As our study attempts to explore potential problems in the implementation of IFRS in China, some dimensions are rather difficult to measure and the use of proxies is not appropriate. Hence, a survey method is more likely to uncover institutional issues and avoid some of the problems associated with inferring intent from statistical methods (Dichev *et al.*, 2013).

We provide insights based on auditors' points of view for the following reasons. First, auditors have extensive experience in verifying whether financial reporting is in accordance with accounting standards (IFRS), the prerequisite being that auditors should understand IFRS well. Second, as auditors have frequent contacts with their clients' accountants, they are able to assess whether the qualifications of accountants are sufficient to implement IFRS. Third, as auditors are exposed to institutional environments, they are the most qualified to assess whether and how institutions affect IFRS implementation.

We developed a questionnaire on the basis of an extensive review of past literature. First, we selected questions from related studies of Australia and Europe (e.g. Larson and Street, 2004; Jermakowicz and Gornik-Tomaszewski, 2006; Morris *et al.*, 2014) to capture some common issues in the process of IFRS implementation.[11] In our survey questions, we excluded the implementation issues that are unique to Australia and Europe and not appropriate in China. Furthermore, we attempted to identify some IFRS implementation issues arising from the uniqueness of China's institutional background by conducting a review of past studies (e.g. Xiang, 1998; Ding and Su, 2008; Liu *et al.*, 2011; He *et al.*, 2012; Nie *et al.*, 2013).

We then combined all the questions appropriate to the context of our study (see the questionnaire in Appendix I). The questionnaire was first written in English and then translated into Chinese to ensure consistency. To ensure that our questions were relevant and appropriate in the context of China, we conducted a pilot test by inviting two professors with extensive teaching expertise in Chinese accounting and three professionals from the Big 4 audit firms to answer the questionnaire. On the basis of their feedback, we modified our questionnaire. For each question, we used a Likert-scale rating (ranging from 1 = strongly disagree to 5 = strongly agree). To mitigate respondents' concerns and potential self-serving bias, we assured anonymity and explained that the responses would only be used for academic research in the introduction section of our questionnaire. To gain further insights in addition to the responses to the multiple-choice questions, we encouraged the respondents to write down comments.

We started the survey in March 2015. As China's audit market is segmented, with Big 4 auditors and top-ranked auditors occupying the high end and lower-ranked local auditors competing for less lucrative small clients (e.g. Gul *et al.*, 2010), we used a stratified sampling method to mitigate bias. We instructed the HR director of each firm to distribute 300 copies of the questionnaire to these three categories of auditor and contacted at least one senior staff member in each auditing firm in China to coordinate the survey in March 2015. By doing so, we were able to ensure a reasonably high return rate. The coordinators returned 197 completed questionnaires (an overall response rate of approximately 58.7%) by August 2015. However, we deleted 21 responses due to the incomplete information provided,

[11] Questions 1 to 4 (see the questionnaire in Appendix I) come from Larson and Street (2004), Jermakowicz and Gornik-Tomaszewski (2006), and Morris *et al.* (2014). Questions 7 and 15 are from Jermakowicz and Gornik-Tomaszewski (2006). We selected questions 20 and 21 from Jermakowicz and Gornik-Tomaszewski (2006) and Morris *et al.* (2014).

leaving 176 valid responses for the data analysis. On average, the Big 4 auditors' client size was larger than that of the other auditors, with the non-top local auditors having the smallest clients. The respondents had at least 3 years' auditing experience and were of auditor rank or above. The proportion of responses from each category of auditor was about the same, suggesting that our survey was representative.

To gain further insights from the auditors, we interviewed five senior auditors to explore missed items in the questionnaire. We interviewed two of them in person and the remaining three by phone. To avoid bias arising from leading questions, we first told the respondents the purpose of the interview and avoided asking leading questions during the interviews. The qualitative insights from the interviews are reported in corresponding sections below. We finished the survey and the interviews in January 2016.

## 3.2 Descriptive Statistics of Respondent Auditors' Demographic Information

In Table 1, we report the respondent auditors' demographic information (affiliation, title, education level, professional qualification, and auditing experience) in general and by each type of auditor. As shown in Panel A, 54 respondents were from three of the Big 4 accounting firms (31%), 56 were from top 10 local auditors (32%), and the remaining 66 were from non-top 10 local auditors (37%). Among the respondents, 17% were auditors, 32% managers, 36% senior managers, and 14% partners. The composition of the sample of respondent auditors allowed us to gather information from different levels of management in audit firms. We were able to access more senior managers and partners from Big 4 and top local auditors than from non-top local auditors because there are few senior positions in the non-top local auditor firms. As regards education level, the highest degree held by the majority (61%) of the respondents was a Bachelor's degree; 36% of them had a Master's degree and 3% only held a diploma certificate. On average, the respondents from the Big 4 and top local auditors held higher academic degrees than those from the non-top local auditors. Most (94%) of the respondents were members of CICPA, and a small proportion (14%) of them had other professional qualifications, including HKICPA, AICPA, CPA Australia, ACCA, CIA, ACA, and FCCA. The diversity of professional qualifications and training offered by the respective accounting associations likely gave the respondents different perspectives on our research questions. Finally, our respondents had several years of auditing experience. The average (median) years of auditing experience was 9.62 (10), and the minimum (maximum) value was 3 (25). The respondents from the top local auditors had longer auditing experience than the other auditors. Taken together, the statistics show that the respondents had sufficient experience, training, and diverse exposure to provide insights in their answers to our questionnaire.

**Table 1 Descriptive Statistics for Respondents (N=176)**

Panel A: Respondents' affiliation

| Affiliation | Big 4 auditors | Top local auditors | Non-top local auditors |
|---|---|---|---|
| N (%) | 54 (31%) | 56 (32%) | 66 (37%) |

Panel B: Respondents' title

| Title | Auditor | Manager | Senior Manager | Partner |
|---|---|---|---|---|
| N (%) | 30 (17%) | 57 (32%) | 64 (36%) | 25 (14%) |
| By auditor: | | | | |
| Big 4 auditors | 0 (0% ) | 24 (44%) | 20 (37%) | 10 (19%) |
| Top local auditors | 0 (0% ) | 9 (16%) | 34 (61%) | 13 (23%) |
| Non-top local auditors | 30 (46%) | 24 (36%) | 10 (15%) | 2 (3%) |

Panel C: Respondents' highest education level

| Education | Diploma | Bachelor's | Master's | Doctorate |
|---|---|---|---|---|
| N (%) | 5 (3%) | 108 (61%) | 63 (36%) | 0 (0%) |
| By auditor: | | | | |
| Big 4 auditors | 0(0%) | 29 (54%) | 25 (46%) | 0 (0%) |
| Top local auditors | 0 (0%) | 34 (61%) | 22 (39%) | 0 (0%) |
| Non-top local auditors | 5 (8%) | 45 (68%) | 16 (24%) | 0 (0%) |

Panel D: Respondents' professional qualifications

| Qualification | CICPA only | CICPA holder with other qualifications | Others |
|---|---|---|---|
| N (%) | 151 (86%) | 14 (8%) | 11 (6%) |
| By auditor: | | | |
| Big 4 auditors | 40 (74%) | 14 (26%) | 0 (0%) |
| Top local auditors | 56 (100%) | 0 (0%) | 0 (0%) |
| Non-top local auditors | 55 (83%) | 0 (0%) | 11 (17%) |

Panel E: Respondents' auditing experience (years)

| Auditing experience | All | Big 4 auditors | Top local auditors | Non-top local auditors |
|---|---|---|---|---|
| Mean | 9.62 | 10.39 | 12.54 | 6.52 |
| Median | 10 | 10 | 12 | 4.75 |

Note: Demographic information includes respondents' title, education attainment, professional qualifications, and years of audit experience. We present the highest degree that respondents obtained.

## 3.3 Statistical Methodology

Our correlation analyses (untabulated) revealed that 19 factors that might impair the effective implementation of IFRS in China were positively and significantly related, suggesting strong interdependence among them. To capture the commonality among these factors and reduce the number of observable variables with a minimum loss of information, we used a factor analysis method. We adopted promax rotation, which first rotates orthogonally and then performs an oblique rotation (Fabrigar *et al.*, 1999; Patil *et al.*, 2008), and identified three factors with eigenvalues larger than one. For clarity of presentation, variables with loadings of less than 0.3 were suppressed for a given factor. The Kaiser-Meyer-Olkin test had a value of 0.828, suggesting that the sample was adequate for performing factor analysis (Worthington and Whittaker, 2006). We labelled the three factors as (1) client perspective, (2) institutions, and (3) audits. In the findings section, we report the loadings in descending order for convenience. We also report descriptive statistics for each question and *t*-test results to demonstrate whether the average rating for a given question was significantly different from 3 (the neutral response). Finally, to explore whether the ratings were conditional on respondent characteristics, we performed an ordered probit regression. More specifically, we examined whether Big 4 (*BIG4* = 1 for Big 4 auditors), top local auditors (*LOCALTOP* = 1 for top 10 local auditors), education level (*EDU* = 1 for diploma to 5 for Doctorate), position (*POSITION* = 1 for staff auditor, 2 for manager, 3 for senior manager, and 4 for partner), and audit experience (*EXPERIENCE*) differed for each question.

## IV. Findings

### 4.1 The Extent of Success

We were interested in whether China has achieved its desired goals of implementing the CAS. We examined this issue from the auditors' perspective on the basis of four observable indicators. Among all the indicators, improved reporting quality scored highest. We report the survey results in Table 2.

As shown in Table 2, 81% of the respondents agreed or strongly agreed that firms that have adopted the CAS have improved reporting quality, the most direct outcome of the implementation of the standards. The average rating was 3.77, significantly different from the neutral rating of 3. This result is consistent with Lin and Chen (2005) and Liu *et al.* (2011) and is evidence that the adoption of IFRS improves reporting quality.

The results show that 53% of the respondents stated that the adoption of the CAS lowers firms' cost of capital. This result is consistent with prior studies (Daske *et al.*, 2008; Li, 2010). The average rating was 3.44, marginally above the neutral rating of 3. One partner told us that the effect of IFRS implementation on the cost of capital is weak and indirect. This is because the effect of IFRS is limited by the extent of capital market development in China. One partner even questioned whether the implementation of IFRS could reduce debt cost. His argument was that with the increased complexity of the standards and the inherent problems of accounting infrastructure, both lenders and borrowers incur more costs in verifying accounting data.

As shown in Table 2, 69% of the respondents stated that the adoption of the CAS has attracted more foreign investors. One partner said that this is through greater exposure to overseas capital through dual listing. Finally, a similar percentage of respondents strongly agreed or agreed that the adoption of CAS promotes corporate governance performance. All these results were significantly different from the neutral rating of 3.

**Table 2 Survey Responses – IFRS Implementation Achievements in China (N=176)**

Panel A: Descriptive Statistics

| No. | Question | Average % (4-5) | Average % (1-2) | Average % (3) | Average | H0: Average rating=3 |
|---|---|---|---|---|---|---|
| (1) | Improved reporting quality | 81% | 11% | 8% | 3.77 | *** |
| | | (142) | (20) | (14) | | |
| (2) | Lowered cost of capital | 53% | 15% | 32% | 3.44 | *** |
| | | (94) | (26) | (56) | | |
| (3) | Attracted more foreign investors | 69% | 5% | 26% | 3.69 | *** |
| | | (122) | (9) | (45) | | |
| (4) | Promoted corporate governance performance | 78% | 8% | 14% | 3.73 | *** |
| | | (137) | (14) | (25) | | |

Panel B: Ordered Probit Regression

| | (1) | (2) | (3) | (4) |
|---|---|---|---|---|
| *BIG4* | 1.073*** | 1.030*** | 0.705** | 0.227 |
| | (2.91) | (3.61) | (2.35) | (0.72) |
| *LOCALTOP* | 1.542*** | 2.206*** | 1.193*** | 0.935** |
| | (3.28) | (5.89) | (3.14) | (2.30) |
| *POSITION* | -0.125 | 0.041 | -0.147 | 0.170 |
| | (-0.64) | (0.27) | (-0.90) | (0.96) |
| *EDU* | 0.097 | -0.101 | 0.055 | 0.190 |
| | (0.47) | (-0.62) | (0.32) | (1.04) |
| *EXPERIENCE* | -0.018 | -0.052* | -0.001 | -0.046 |
| | (-0.55) | (-1.87) | (-0.04) | (-1.48) |
| Location Dummies | Yes | Yes | Yes | Yes |
| P-value of Wald Test: *BIG4 vs. LOCALTOP* | 0.140 | 0.000*** | 0.062* | 0.014** |
| Observations | 176 | 176 | 176 | 176 |
| Pseudo $R^2$ | 0.140 | 0.000 | 0.062 | 0.014 |

Note: *t* statistics in parentheses; $^{*}p < .1$, $^{**}p < .05$, $^{***}p < .01$.

The regression results in Panel B show that both the local top auditors and the international Big 4 auditors were more likely to agree that the adoption of IFRS has improved reporting quality, lowered the cost of capital, and attracted foreign investors than the non-top local auditors. Only the local top auditors were more likely to agree that the adoption of IFRS has improved firms' governance performance. The results also show that the top local auditors were more likely than the Big 4 auditors to agree that the adoption of IFRS has achieved the goals (except for improved reporting quality). One possible explanation is that the clients of local top auditors are more likely to lack good corporate governance than the client of Big 4 auditors; therefore, the adoption of IFRS has a more pronounced effect on such firms.

The results consistently show that the implementation of CAS has achieved its desired goals in terms of different indicators. However, one senior manager commented that "the implementation of CAS is still on the way to achieving the above goals … but the future is brilliant and our confidence is still there."

## 4.2 Client Perspective

The first factor, client perspective, accounted for 61% of the variance in the data (see Table 3, Panel A). This factor comprised 11 factors, five pertaining to the characteristics of accounting standards, two related to government and capital markets, and four related to client characteristics. Among these, those with the highest five loadings, in descending order, were weak commitment from top management, weak corporate governance at board level, a lack of uniform interpretation of the CAS, a lack of CAS implementation guidance, and the huge costs of implementation, suggesting that the standards and client characteristics are the most important factors affecting IFRS implementation. In the following sections, we divide the factors into three subcategories—accounting standards, financial statement preparers' characteristics, and government and capital market—and discuss each category in detail.

### 4.2.1 Accounting standards

As shown in Table 2, 62% of the respondents (109) agreed or strongly agreed that the complex nature of CAS hinders its successful implementation. The average rating (3.49) was significantly different from the neutral rating of 3. The regression results (Panel B) show that the large auditors were more likely to agree with this argument than the non-top local auditors. One senior manager elaborated: "FV accounting is the weakest area of China's accounting practice. Users of financial statements do not have the ability to interpret the disclosure." This may be explained by the notion that China's underdeveloped marketisation level does not support FV, although this is widely adopted in the CAS.[12] One partner pointed out that some standards, for example CAS 10 (enterprise annularity funds), CAS 11 (share-based payment), and CAS 24 (hedging accounting) are too complicated. In addition to the complexity issue, another partner pointed out that some standards provide room for manipulation: for example, the standard that requires the proceedings from debt restructuring to be recognised in the income statement provides opportunities for managers to increase profits by a huge amount.

The majority of the respondents also agreed or strongly agreed that a lack of implementation guidance (69%) and uniform interpretation (74%) adversely affects the successful implementation of the standards. The regression results (Table 3 Panel B) show that the top local auditors were more likely to agree with this argument than the other auditors. This may be because top local auditors have less IFRS implementation experience than their Big 4 counterparts and thus see clear guidance as an important factor. Under the old accounting systems, China's accountants followed clear guidance to prepare financial

[12] An important feature of the CAS is the wide application of FV, a concept originating in arm's length exchange. FV is applied to many transactions, including investment properties, debt reorganisation, financial instruments, and biochemical products. Twenty five of the 38 specific standards issued under the CAS require accountants to use FV measures (Qu and Zhang, 2015).

**Table 3 Survey Responses – Obstacles to IFRS Implementation in China: Client Perspective (N=176)**

Panel A: Factor Analysis

| No. | Issue ranked by factor loading | Factor loadings | Average % (4-5) | Average % (1-2) | Average % (3) | Average | H0: Average rating=3 |
|---|---|---|---|---|---|---|---|
| (3) | Lack of uniform interpretation of CAS | 0.686 | 74% (131) | 16% (28) | 10% (17) | 3.69 | *** |
| (2) | Lack of CAS implementation guidance | 0.669 | 69% (122) | 18% (32) | 13% (22) | 3.59 | *** |
| (1) | Complex nature of CAS | 0.483 | 62% (109) | 20% (36) | 18% (31) | 3.49 | *** |
| (4) | Impact on profit and loss | 0.422 | 45% (79) | 18% (32) | 37% (65) | 3.30 | *** |
| (5) | Weak commitment at top management level | 0.763 | 64% (112) | 19% (33) | 18% (31) | 3.57 | *** |
| (8) | Weak corporate governance at board level | 0.715 | 64% (113) | 9% (15) | 27% (48) | 3.62 | *** |
| (6) | (Client) Huge costs of implementation | 0.572 | 60% (106) | 23% (40) | 17% (30) | 3.47 | *** |
| (9) | Difficult to change the mindset of finance personnel | 0.400 | 75% (132) | 13% (22) | 13% (22) | 3.69 | *** |
| (7) | Lack of CAS knowledge among accounting staff | 0.395 | 88% (155) | 4% (7) | 8% (14) | 4.05 | *** |
| (10) | Government's improper involvement in reporting practice | 0.362 | 57% (100) | 11% (20) | 32% (56) | 3.55 | *** |
| (11) | Underdeveloped capital market | 0.308 | 76% (133) | 9% (15) | 16% (28) | 3.80 | *** |

Note: Eigenvalue 5.82; variance explained: 61%.

Panel B: Ordered Probit Regression

| | (1) | (4) | (5) | (6) | (7) | (10) | (11) |
|---|---|---|---|---|---|---|---|
| *BIG4* | 0.823*** | 0.001 | 0.314 | 0.270 | -0.164 | 0.312 | 0.212 |
| | (2.83) | (0.00) | (1.14) | (0.96) | (-0.56) | (1.15) | (0.74) |
| *LOCALTOP* | 2.029*** | 1.168*** | 1.004*** | 1.219*** | 0.530 | 0.981*** | 1.044*** |
| | (5.21) | (3.37) | (2.88) | (3.35) | (1.44) | (2.85) | (2.89) |
| *POSITION* | 0.194 | 0.153 | 0.134 | 0.289* | 0.261 | 0.010 | 0.121 |
| | (1.24) | (1.02) | (0.88) | (1.85) | (1.57) | (0.07) | (0.78) |
| *EDU* | -0.038 | -0.173 | -0.176 | -0.358** | -0.002 | -0.004 | 0.004 |
| | (-0.23) | (-1.08) | (-1.09) | (-2.16) | (-0.01) | (-0.02) | (0.02) |
| *EXPERIENCE* | 0.004 | 0.022 | 0.007 | 0.017 | 0.029 | 0.019 | 0.011 |
| | (0.15) | (0.81) | (0.24) | (0.60) | (0.95) | (0.68) | (0.38) |
| Location Dummies | Yes | Yes | Yes | Yes | Yes | Yes | Yes |
| P-value of Wald Test: *BIG4 vs. LOCALTOP* | 0.000*** | 0.000*** | 0.004*** | 0.000*** | 0.008*** | 0.005*** | 0.001*** |
| Observations | 176 | 176 | 176 | 176 | 176 | 176 | 176 |
| Pseudo $R^2$ | 0.144 | 0.110 | 0.090 | 0.153 | 0.090 | 0.073 | 0.061 |

Note: $t$ statistics in parentheses; $^{*}$ $p < .1$, $^{**}$ $p < .05$, $^{***}$ $p < .01$.

statements. The lack of implementation guidance becomes more acute in an environment in which accounting practices are subject to various authoritative sources. One partner pointed out that "different regulators may have different views of accounting standards interpretation. Some regulators may request a certain accounting treatment which conflicts with the requirement of the CAS." As a result, understandable and clear guidance is particularly important in China because the majority of accountants lack sufficient IFRS training.

Only 45% of the respondents agreed or strongly agreed that the effect of the CAS on net income influences the implementation of these standards. The average rating was 3.3, marginally above the neutral rating (3). The regression results (Table 3 Panel B) show that the top local auditors were more likely to agree with this argument than the other auditors. One partner who disagreed with the argument pointed out that "[the effect of the CAS] might be neutral as the new CAS may increase the net income as well as decrease it". Overall, the effect on profit was not a concern.

Overall, the results also show that the local top auditors were more likely to agree that the barriers have impeded the successful implementation of IFRS in China than the Big 4 and non-top local auditors. This is probably because the clients of top local auditors experience more difficulties in implementing IFRS than the clients of other auditors. Taken together, the results suggest that the CAS, building on IFRS, which are complex and not coupled with clear implementation guidance and uniform interpretation, hinders the successful implementation of the standards.

### 4.2.2 Financial statement preparers' characteristics

The second category of questions concerned whether the characteristics of different clients (i.e. report preparers) affect the implementation of the standards. In China, the government controls major listed SOEs and the ownership structure of private firms is concentrated. This ownership structure means that the demand for high-quality financial statements for contracting is weak. We did not include the effect of concentrated ownership in the questionnaire because concentrated ownership is common in China and there should be a consensus among auditors on the influence of concentrated ownership on financial reporting quality. However, we interviewed three partners and their responses confirmed the argument that concentrated ownership structure reduces the demand for high-quality financial reports and therefore adversely affects the successful implementation of the CAS in China. We considered factors at different levels, ranging from top managers to accountants, because successful implementation of the standards hinges on commitment at all levels within a firm.

The results show that 64% of the respondents (112) agreed that a lack of commitment at the top management level adversely affects the implementation of the standards in China. The average rating (3.57) was significantly different from 3. The top local auditors saw this as particularly important, as shown in the regression result in Table 3 Panel B (the coefficient on *LOCALTOP* is also significantly higher than *BIG4*); this is probably because local auditors have less bargaining power than their Big 4 peers. One local partner said that the most important factor is the mindset of top management. Given the limited role of accounting in valuation and controllership in China, top management does not view financial reporting as important. The huge cost of implementation is another important factor that hinders successful implementation of the standards. The average rating was 3.47, significantly different from the neutral rating (3). According to regression results from Panel B, the local top auditors considered the cost of implementation more important; this is probably due to the fact that local auditors charge less than Big 4 auditors and thus tend to be more cost sensitive.

More than 88% of the respondents agreed or strongly agreed that a lack of CAS knowledge among accounting staff hinders the successful implementation of the standards. The average rating was 4.05, the highest score in this category, suggesting that this factor is the most important of all in this section. Although in Panel B, the coefficients for local top auditors and Big 4 auditors are both statistically significant, the difference is positively significant. These results suggest that local top auditors and Big 4 auditors face accounting staff with varied professional knowledge during audit engagements. The results are consistent with prior studies (e.g. Ding and Su, 2008; Nie *et al.*, 2013). One partner told us that the implementation costs stem from training costs and other costs associated with more complex accounting treatments. He further elaborated with an example: FV requires firms to hire a valuation company to provide FV of assets, resulting in a significant implementation expense. The degree of staff members' understanding of the CAS and implementation costs varies by firm. One senior manager told us that "[b]ig SOEs are easier because they have highly capable accountants. However, many small clients lack the ability to prepare full-scale financial statements."

Another reason, as one partner suggested, is that top managers do not view accounting as important for business operations, resulting in a weak motivation to implement IFRS. Although China's code of corporate governance stresses the importance of the board of directors, particularly independent directors, in the production of financial statements, whether independent directors play their role is still questionable. In China, controlling shareholders can appoint independent directors who have social ties with them, reducing the effectiveness of these directors. In addition, many independent directors lack business experience and thus are not able to monitor the financial statement production process. Not surprisingly, 64% of the respondents considered weak corporate governance at board level an important factor behind ineffective implementation of the standards. The average rating was 3.62, significantly different from the neutral rating of 3. The regression results (Table 3 Panel B) show that no factor was significantly associated with this statement but the difference between the local top auditors' and the Big 4 auditors' views of this factor was significant, probably because board monitoring matters when corporate governance as a whole is weak (i.e. clients of local top auditors). One partner explained that the board "only solves significant issues sometimes." This implies that boards of directors do not prioritise financial reporting as a primary issue in China. One partner pointed out that "[i]n the mindset of some managements and boards, the financial statements are not considered as a high priority in the company. As such, there is no motivation to change the accounting standards." The result suggests that the mindset at senior management level is an important factor that influences the effective implementation of IFRS.

Finally, the mindset of financial personnel is another factor that the majority of respondents considered impedes the successful implementation of the standards. The average rating was 3.69, significantly different from the neutral rating of 3. Neither the local top auditors nor the Big 4 auditors viewed this factor as important, but it seemed to be more of an issue for the local top auditors (significant coefficients difference shown in Panel B). This is consistent with the fact that China's accountants who have been trained under a rules-based accounting system have difficulty changing their mindset to IFRS. Under the planned economy system, accountants are required to follow specific rules and are not encouraged to use their discretion to better map accounting data to economic realities. One partner described how an accountant is like a statistician under the old system and does not even understand the valuation role of accounting. Another partner further pointed out that insufficient training and lack of continuous education have a negative effect on accountants' interpretation of the standards.

Taken together, the survey results suggest that clients' characteristics are important in implementing IFRS, which is consistent with prior studies (Ding and Su, 2008; Nie *et al.*, 2013). One suggestion for better implementation is to consider the various aspects of corporate governance, commitment, mindset, training in IFRS, and sufficient budget.

### 4.2.3 Government and capital market

Our results show that 57% of the respondents considered improper government involvement in reporting practice to be an important factor that contributes to ineffective implementation of the standards. The average rating was 3.55, significantly different from the neutral rating of 3. Panel B also shows that during the IFRS adoption process, this factor impedes local top auditors more than it does Big 4 auditors. The clients of Big 4 auditors tend to be international firms, and so the government in China may have less impact on them. This result is consistent with Ding and Su (2008). The regression results (Table 3 Panel B) show that the top local auditors were more likely to agree with this argument than the other auditors (the coefficient on *LOCALTOP* is also significantly higher than that on *BIG4*). One partner told us that the government has a strong incentive to maintain listed firms' good financial performance and to avoid delisting, as failure to do so signals weak leadership in economic affairs. He further pointed out that the government is likely to intervene in accounting practices in two ways: by increasing firms' profits with subsidies and by pressuring local auditors to give favourable opinions.

China's stock market is still not efficient (e.g. Morck *et al.*, 2000; Piotroski and Wong, 2012). Our results also show that 76% of the respondents (133) agreed or strongly agreed that an underdeveloped capital market hinders implementation of the standards, which is consistent with prior literature (Ding and Su, 2008; He *et al.*, 2012; Nie *et al.*, 2012). Like the last question, the regression results (Table 3 Panel B) show that the top local auditors were more likely to agree with this argument than the other auditors (the coefficient on *LOCALTOP* is also significantly higher than that on *BIG4*). Two partners summarised two points: i) an insufficient stock market cannot provide the infrastructure for FV and ii) the opacity of financial reporting makes it difficult for accountants to measure the FV of invested firms' equity values.

## 4.3 Audits

The role of auditors is to ensure that their clients' financial statements are prepared following accounting standards. As in many emerging economies, China's audit market is segmented, with Big 4 international auditors and top local auditors having a significant fraction of the high-end market and other local auditors competing for less lucrative clients. Unlike the Big 4 international auditors and top local auditors, non-top local auditors have a lower capacity and incentive to provide better-quality audits. China's unique audit regulation system also limits non-top local auditors' ability to independently assess compliance with financial standards.

The Big 4 have a greater capacity and greater incentives to provide a better service than their local counterparts can in China's market (e.g. Gul *et al.*, 2010). Due to the segmentation of the audit market and different business models, we asked the first four questions about both Big 4 and non-Big 4 auditors. Some of our respondents replied that they were not able to answer questions related to non-Big 4 firms due to their unfamiliarity with them. We report the results in Table 4.

**Table 4 Survey Responses – Obstacles to IFRS Implementation in China: Audits (N=176)**

Panel A: Factor Analysis

| No. | Issue ranked by factor loading | Factor loadings | Average % (4-5) | Average % (1-2) | Average % (3) | Average | H0: Average rating=3 |
|---|---|---|---|---|---|---|---|
| (1) | High implementation costs | 0.780 | 28%<br>(50) | 50%<br>(88) | 22%<br>(38) | 2.73 | Not Sig |
| | Big N auditors | | 27%<br>(48) | 41%<br>(73) | 31%<br>(55) | 2.85 | Not Sig |
| | local auditors | | 33%<br>(58) | 45%<br>(80) | 22%<br>(38) | 2.85 | Not Sig |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| (2) | Lack of auditor independence | 0.731 | 18% (32) | 55% (97) | 27% (47) | 2.53 | Not Sig |
| | Big N auditors | | 21% (37) | 55% (97) | 24% (42) | 2.53 | ** |
| | local auditors | | 24% (43) | 40% (71) | 35% (62) | 2.81 | Not Sig |
| (3) | Weak motivation of auditors because of pay | 0.716 | 27% (47) | 43% (75) | 31% (54) | 2.79 | Not Sig |
| | Big N auditors | | 31% (54) | 47% (82) | 23% (40) | 2.73 | Not Sig |
| | local auditors | | 42% (74) | 27% (48) | 31% (54) | 3.18 | ** |
| (4) | Lack of CAS knowledge among auditors | 0.570 | 28% (49) | 51% (90) | 21% (37) | 2.72 | Not Sig |
| | Big N auditors | | 32% (57) | 50% (88) | 18% (31) | 2.76 | Not Sig |
| | local auditors | | 36% (64) | 37% (65) | 27% (47) | 3.05 | Not Sig |
| (5) | Weak enforcement of auditing regulatory bodies | 0.553 | 20% (36) | 53% (94) | 26% (46) | 2.63 | Not Sig |

Note: Eigenvalue 1.68; variance explained: 18%.

Panel B: Ordered Probit Regression

| | (1) | (2) | (3) | (4) | (5) |
|---|---|---|---|---|---|
| *BIG4* | -0.315 | -0.743*** | -0.459* | -0.432 | -0.242 |
| | (-1.13) | (-2.72) | (-1.68) | (-1.52) | (-0.89) |
| *LOCALTOP* | 0.465 | 0.031 | -0.275 | 0.481 | 0.010 |
| | (1.34) | (0.09) | (-0.82) | (1.36) | (0.03) |
| *POSITION* | 0.287* | 0.204 | 0.127 | 0.053 | 0.335** |
| | (1.87) | (1.38) | (0.85) | (0.35) | (2.20) |
| *EDU* | -0.187 | -0.055 | -0.206 | -0.276* | -0.107 |
| | (-1.14) | (-0.35) | (-1.29) | (-1.67) | (-0.68) |
| *EXPERIENCE* | -0.002 | -0.023 | 0.007 | 0.055* | -0.011 |
| | (-0.07) | (-0.85) | (0.27) | (1.95) | (-0.39) |
| Location Dummies | Yes | Yes | Yes | Yes | Yes |
| P-value of Wald Test: *BIG4 vs. LOCALTOP* | 0.001*** | 0.001*** | 0.431 | 0.000*** | 0.279 |
| Observations | 176 | 176 | 176 | 176 | 176 |
| Pseudo $R^2$ | 0.060 | 0.040 | 0.028 | 0.083 | 0.027 |

Note: *t* statistics in parentheses; $^{*}p < .1$, $^{**}p < .05$, $^{***}p < .01$.

Among the respondents, 41% disagreed or strongly disagreed that high implementation costs impede successful implementation of the standards for Big-4 clients. The proportion was around 45% for non-Big 4 auditors. One partner pointed out that large firms have greater resources to provide their auditors with sufficient training and information systems and as such they are more competitive. High-ranked auditors are more likely to agree with this statement (as shown in Panel B) than other auditors (the coefficient on *POSITION* is significant), probably because they understand the implementation costs better.

The second question concerned whether a lack of independence impairs the successful implementation of the standards. In China, different types of auditor face different factors that may impair their independence. Thanks to their superior position in China's audit market, the Big 4 auditors have large quasi-rents and thus have a stronger incentive to act independently to protect their reputation capital (DeAngelo, 1981). As indicated in Table 4, the respondents viewed the Big 4 as being more independent and thus more likely to provide better assurance for IFRS-based financial reporting. Conversely, they had great concerns that the independence problem of non-top auditors would impair the successful implementation of IFRS. Interestingly, as shown in Panel B, the Big 4 auditors were less likely to agree that lack of independence is an issue, probably because the sound internal control systems in Big 4 firms give them confidence in their ability to maintain independence. One partner pointed out that two factors, namely government and the market, affect independence. As Chan *et al.* (2006) suggest, governments will press local auditors to issue favourable opinions to their SOE clients. The partner pointed out that severe competition among local non-top auditors has already forced them to lower their fees, and thus they are more likely to sacrifice independence.

The results also reveal that lower pay does not weaken the Big 4 auditors' ability to successfully implement the standards. However, the rating was not significant in the non-Big 4 groups, suggesting that lower pay may be a concern for non-Big 4 auditors. As shown in Panel B, the Big 4 auditors were less likely to agree with the statement than the non-top local auditors, probably because the compensation system in Big 4 firms is fair. One partner noted that "low pay to local auditors impairs full compliance with CAS."

Thirty-one percent of the respondents disagreed or strongly disagreed that a lack of CAS knowledge among Big 4 auditors impairs successful implementation of the standards. The average rating was 2.72, insignificantly different from the average rating of 3.05 for the same statement for local auditors. The average rating was significantly different from the neutral rating, suggesting that Big 4 auditors are well trained to verify financial statements under IFRS. As shown in Panel B, the better-educated (more experienced) auditors were less (more) likely to agree with the statement than the other auditors (the coefficients on *EDU* and *EXPERIENCE* are significant), probably because they realise this problem exists in local offices. One of the partners attributed this to the Big 4's strict independence rule and practices. Another partner argued that "Big 4 auditors are well trained in IFRS and have enough relevant experience …[as well as] strict independence rule and practices … accordingly the implementation costs could not be very significant." Some respondents, however, stated that both Big 4 and non-Big 4 auditors in China are equipped with sufficient knowledge to implement the standards.

Finally, half of the respondents disagreed or strongly disagreed that weak enforcement by auditing regulatory bodies is a factor that impairs the successful implementation of the standards. The average rating was 2.63, insignificantly different from the neutral rating. The regression results in Panel B show strong support from high-ranked auditors (the coefficient on *POSITION* is significant). One partner stated: "[W]e face too many inspections from different regulatory bodies every year." However, another partner noted that the focus of the regulatory body is on audits not accounting standards.

The results suggest that audit-related issues do not impede the successful implementation of the standards. However, we caution that there is potential reporting bias due to the background of the respondents.

## 4.4 Institutions

The third category of questions concerned whether institutional characteristics affect the implementation of the standards. In China, many institutions, including the tax regime, the capital market, government, and regulatory enforcement, are likely to affect the implementation of IFRS.

**Table 5 Survey Responses – Obstacles to IFRS Implementation in China: Institutions (N=176)**

Panel A: Factor Analysis

| No. | Issue ranked by factor loading | Factor loadings | Average % (4-5) | Average % (1-2) | Average % (3) | Average | H0: Average rating=3 |
|---|---|---|---|---|---|---|---|
| (1) | Tax-driven nature of national accounting regime | 0.815 | 79% (139) | 7% (13) | 14% (24) | 3.98 | *** |
| (2) | No vibrant market for implementation of fair value accounting | 0.650 | 90% (158) | 3% (5) | 7% (13) | 4.19 | *** |
| (3) | Weak enforcement of regulatory bodies | 0.488 | 72% (127) | 10% (17) | 18% (32) | 3.70 | *** |

Note: Eigenvalue 1.07; variance explained: 11%.

Panel B: Ordered Probit Regression

| | (1) | (2) | (3) |
|---|---|---|---|
| *BIG4* | -0.236 | 0.207 | -0.428 |
| | (-0.85) | (0.71) | (-1.50) |
| *LOCALTOP* | 0.104 | 0.768** | 0.215 |
| | (0.30) | (2.09) | (0.59) |
| *POSITION* | 0.241 | -0.080 | 0.147 |
| | (1.57) | (-0.49) | (0.90) |
| *EDU* | -0.378** | -0.235 | -0.509*** |
| | (-2.31) | (-1.37) | (-2.95) |
| *EXPERIENCE* | 0.007 | 0.060** | 0.015 |
| | (0.24) | (1.99) | (0.49) |
| Location Dummies | Yes | Yes | Yes |
| P-value of Wald Test: *BIG4 vs. LOCALTOP* | 0.157 | 0.028** | 0.011** |
| Observations | 176 | 176 | 176 |
| Pseudo $R^2$ | 0.044 | 0.082 | 0.087 |

Note: *t* statistics in parentheses; $^{*}p < .1$, $^{**}p < .05$, $^{***}p < .01$.

China's taxation authority strongly influences accounting practices, although tax and financial accounting are separated. The great compliance cost of taxation accounting coupled with the gap between financial accounting and tax accounting could lead to accountants not following tax accounting rules, which may sacrifice relevance. As indicated in Table 5, 79% of the respondents (139) agreed or strongly agreed that the tax regime adversely affects effective implementation of the standards. The average rating was 3.98, significantly different from the neutral rating of 3. As shown in Panel B, the better-educated auditors were less likely to agree with the statement (the coefficient on *EDU* is significant). The results are consistent with prior literature (Ali and Hwang, 2000) showing that financial reporting quality tends to be lower when tax regimes have a greater influence on financial reporting practices.

More than 90% of the respondents agreed or strongly agreed that the lack of a vibrant market for the implementation of FV accounting hinders the successful implementation of the standards. The average rating was 4.19, the highest score in this category, suggesting that this factor is the most important of the institutional factors. As shown in Panel B, the local top auditors are more likely to agree with statement (2) than Big 4 auditors (the coefficient on *LOCALTOP* is also significantly higher than that on *BIG4*), probably because local top auditors have less professional knowledge in FV accounting. Our survey results are generally consistent with the findings of He *et al.* (2012). The degree of marketisation also affects the implementation of FV accounting. In some provinces, the level of marketisation is lower, and hence FV is not reliable.

Finally, weak enforcement by the regulatory body is another factor that the majority of the respondents (72%) considered to be impeding the successful implementation of the standards. The average rating was 3.7, significantly different from the neutral rating of 3. As shown in Table 5 Panel B, the better-educated auditors were less likely to agree with statement (3) (the coefficient on *EDU* is significant). One partner stated: "There are routine examinations on financial reporting quality performed by the CSRC and the MOF. [However], the enforcement is not weak." The focus of the taxation authority is to examine compliance with taxation accounting rules, and thus the taxation authority cannot improve the IFRS. The problem with the MOF is its lack of sufficient manpower, and thus its investigations are limited to large firms, leaving a vast number of firms with lower investigation risks. One partner pointed out that the detection risk is lower because social connections are a viable way to avoid punishment.

## V. Conclusion

Uniform accounting standards facilitate international trade and investment in a globalised world. Although a large number of countries have adopted IFRS, the implementation process is uneven and "uneven implementation curtails the ability of uniform standards to reduce information costs and information risk" (Ball, 2006). Recent studies further offer evidence that adoption of IFRS does not necessarily achieve the desired goals, particularly in emerging economies. We attempted to shed some light on this issue by conducting a survey and follow-up interviews to investigate the obstacles to and achievement of IFRS adoption in China, the largest emerging economy in the world.

The results show that the implementation of IFRS has achieved its goals of improving reporting quality, lowering the cost of capital, attracting more foreign investors, and promoting corporate governance performance, although some auditors question the causality. However, a significant number of our respondents still questioned the success. Our survey also identifies several factors pertaining to standards, clients, auditors, and institutions that impair the successful implementation of IFRS. Qualitative feedback from the respondents provided further insight into how these factors affect IFRS implementation.

Our study reveals several problems in the process of implementing IFRS in China. To the best of our knowledge, it is the first study based on a survey to systematically investigate IFRS implementation issues in China. The findings from our study have implications for other emerging economies with similar institutional backgrounds and SME standards. Our study also constitutes a framework for analysing IFRS implementation issues.



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# Appendix I: Survey Questionnaire

**Part I: Demographic Information**

Title/ position: Years of audit experience:

Qualification: Education:

**Part II: Questions Regarding Implementation Obstacles**

Note: Please tick one of the boxes beside each question in accordance with the following ratings:

(1) strongly disagree; (2) disagree; (3) neither disagree nor agree; (4) agree; (5) strongly agree

**To what extent do you think the following factors impair effective implementation of the CAS in China?**

| | | | | | | |
|---|---|---|---|---|---|---|
| 1 | Complex nature of the CAS | 1 | 2 | 3 | 4 | 5 |
| 2 | Lack of CAS implementation guidance | 1 | 2 | 3 | 4 | 5 |
| 3 | Lack of uniform interpretation of the CAS | 1 | 2 | 3 | 4 | 5 |
| 4 | Impact on profit and loss | 1 | 2 | 3 | 4 | 5 |
| **Other factors/comments/explanations:** | | | | | | |
| | | | | | | |
| 5 | Weak commitment at top management level | 1 | 2 | 3 | 4 | 5 |
| 6 | Huge costs of implementation | 1 | 2 | 3 | 4 | 5 |
| 7 | Lack of CAS knowledge among accounting staff | 1 | 2 | 3 | 4 | 5 |
| 8 | Weak corporate governance at board level | 1 | 2 | 3 | 4 | 5 |
| 9 | Difficult to change the mindset of finance personnel | 1 | 2 | 3 | 4 | 5 |
| **Other factors/comments/explanations:** | | | | | | |
| | | | | | | |
| 10 | Tax-driven nature of national accounting regime | 1 | 2 | 3 | 4 | 5 |
| 11 | Underdeveloped capital market | 1 | 2 | 3 | 4 | 5 |
| 12 | No vibrant market for implementation of fair value accounting | 1 | 2 | 3 | 4 | 5 |
| 13 | Government's improper involvement in reporting practice | 1 | 2 | 3 | 4 | 5 |
| 14 | Weak enforcement of regulatory bodies | 1 | 2 | 3 | 4 | 5 |
| **Other factors/comments/explanations:** | | | | | | |

| | | | | | | |
|---|---|---|---|---|---|---|
| 15 | Lack of CAS knowledge among auditors | | | | | |
| | Big N auditors | 1 | 2 | 3 | 4 | 5 |
| | local auditors | 1 | 2 | 3 | 4 | 5 |
| 16 | Lack of auditor independence | | | | | |
| | Big N auditors | 1 | 2 | 3 | 4 | 5 |
| | local auditors | 1 | 2 | 3 | 4 | 5 |
| 17 | High implementation costs | | | | | |
| | Big N auditors | 1 | 2 | 3 | 4 | 5 |
| | local auditors | 1 | 2 | 3 | 4 | 5 |
| 18 | Weak motivation of auditors because of pay | | | | | |
| | Big N auditors | 1 | 2 | 3 | 4 | 5 |
| | local auditors | 1 | 2 | 3 | 4 | 5 |
| 19 | Weak enforcement of auditing regulatory bodies | 1 | 2 | 3 | 4 | 5 |
| **Other factors/ comments/explanations:** | | | | | | |

**Part III: Questions Regarding Implementation Achievements**

Note: Please tick one of the boxes beside each question in accordance with the following ratings:

(1) strongly disagree; (2) disagree; (3) neither disagree nor agree; (4) agree; (5) strongly agree

**To what extent do you think implementation of the CAS in China has achieved the following goals?**

| | | | | | | |
|---|---|---|---|---|---|---|
| 20 | Improved reporting quality | 1 | 2 | 3 | 4 | 5 |
| 21 | Lowered cost of capital | 1 | 2 | 3 | 4 | 5 |
| 22 | Attracted more foreign investors | 1 | 2 | 3 | 4 | 5 |
| 23 | Promoted corporate governance performance | 1 | 2 | 3 | 4 | 5 |
| **Other achievements/ comments/explanations:** | | | | | | |

*** For each of the items in Parts II and III, please give a brief explanation on a separate sheet.**