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IFRS in China

In early 2009, the world economy was in a state of crisis. The IMF had announced in January that global GDP had contracted 5% in the fourth quarter of 2008. "We now expect the global economy to come to a virtual halt," said the IMF's chief economist, adding that advanced economies could see further contraction over the coming year.[1] Amid the global gloom, China was one of few countries that were expected to see strong economic growth.

As the crisis brewed, China had been in the midst of a major overhaul of its accounting practices. In 2005, it had announced plans to converge its accounting standards with International Financial Reporting Standards (IFRS). This move was driven, in part, by concerns that China's weak accounting structure and questionable corporate reporting practices had the potential to hinder the efficient allocation of capital within the country.[2] In 2006, China introduced new accounting standards that, with a few notable exceptions, were identical to IFRS. By 2008, listed companies on China's two major stock exchanges as well as most of the country's largest state-owned enterprises (SOEs) had already begun using the new standards. By 2011, all Chinese companies were expected to adopt them.[3]

But times had changed since 2005. In the wake of the financial crisis, the developed world's accounting practices no longer looked so attractive to China. The Chinese government also faced major challenges in maintaining its desired level of GDP growth. Its export markets were expected to recover slowly, if at all. Moving to IFRS promised to be expensive and disruptive. And one thing was fairly certain: with or without IFRS, China was going to remain a major force in the global economy.

The Chinese Economy in 2009

The phenomenal growth of the Chinese economy was one of the most significant international developments of the late twentieth century. Before 1978, China's centrally planned, socialist command economy engaged in very little international trade. Over the next three decades, annual GDP growth averaged 15% as a series of dramatic reforms created a market-oriented economy that was highly integrated into the world trading system. China's exports were more than US$1.4 trillion in 2008, up from US$195 billion in 1999.[4] By 2009, China was the world's third-largest economy with a real GDP of more than US$4.4 trillion (in current dollars). (See **Exhibit 1** for China's historical GDP growth.)

Professor Karthik Ramanna and HBS Asia-Pacific Research Center (APRC) Senior Researchers G.A. Donovan and Nancy Hua Dai prepared this case. HBS cases are developed solely as the basis for class discussion. Cases are not intended to serve as endorsements, sources of primary data, or illustrations of effective or ineffective management.

Despite the comparatively large size of its economy, China was considered a lower-middle-income country. It ranked only 106th on a per capita GDP basis.[5] China's population was vast—more than 1.3 billion people—and the majority were farmers who earned little cash income. Over 20 million young people entered the job market each year. Urban unemployment was high. Under these conditions, continued strong economic and employment growth was essential. China's government continually adjusted monetary and regulatory policy to attract and develop capital sources. But it preferred to introduce major reforms gradually, on a small scale or at the local level, before they were adopted nationwide. In some cases this was necessary when reforms were opposed by entrenched interests. The communist-era command economy had been largely dismantled, but China's largest enterprises were still owned and controlled by the state. All of the 34 Chinese companies in the 2009 Global Fortune 500 were state-owned (**Exhibit 2**).

Much of China's spectacular economic expansion was driven by rising exports and government spending on infrastructure and other investments. Beginning in 1992, economic liberalization accelerated and the country integrated more fully into the global economy. China joined the World Trade Organization (WTO) in 2001. Around the same time, it became notably more dependent on imported inputs, particularly to meet its growing energy needs. Nonetheless, China's persistent and growing trade surplus led critics to question whether trade with China was conducted fairly (see **Exhibit 3** for China's historical balance of trade). China's trade competitors increasingly resorted to tariffs and other measures to counter what they saw as unfair trading advantages such as the "dumping" of Chinese manufactured products.[a]

Capital markets in China were small relative to the size of the economy. Shareholding first emerged in the mid-1980s as part of the central government's efforts to create greater operating efficiencies in SOEs by making them more like corporations. There were two major stock exchanges located in Shanghai and Shenzhen. Their total market capitalization was less than US$2 trillion in mid-2009, or only about 10% of the capitalization of the New York Stock Exchange. Most shares were denominated in RMB ("A Shares"), but a small number were denominated in either U.S. or Hong Kong dollars ("B Shares"). Many Chinese companies preferred to list or to have a second listing on the stock market in the former British colony of Hong Kong (known in China as "H Shares") or in New York, London, or Toronto. As of June 2009, the market capitalization of the 65 mainland Chinese firms listed on the NYSE was US$1.1 trillion, or more than half the total market capitalization of China's domestic stock exchanges. The 10 largest Chinese companies on the NYSE had a market value of over US$965 billion (**Exhibit 4**).

Retail participation in the domestic stock market was high. Small investors traded domestic stocks in more than 60 million individual investor accounts. China had a very high personal savings rate, but the relatively underdeveloped local financial industry left few investment options other than stocks and property.

Accounting and Accounting Standards in China

After the founding of the People's Republic of China in 1949, Chinese accounting practices developed to meet the needs of the county's nonmarket, planned economy. There was no private capital under the communist system. Enterprises paid no taxes; instead, they simply turned any surplus over to the treasury. Accounting relied largely on practices borrowed from the Soviet Union

[a] "Dumping" occurred when merchandise was sold in a foreign market at less than its normal value; the value was determined by the price of the merchandise in its home market or by the cost of production.

and focused on tracking inputs and outputs at the various SOEs as a means of asserting control over the state's assets.

This began to change with the process of "reform and opening up" in the late 1970s. China began to welcome foreign investment in Special Economic Zones (SEZs). Export manufacturing quickly developed as a major source of both employment and foreign currency. By the mid-1980s, a business income tax had been instituted and some state firms were selling shares. These developments created a need for a more advanced accounting system that better suited a market-based economy.

China's first Accounting Law was enacted in 1985, and over the next two decades China sought to modernize its accounting practices as it geared up for the next stage of economic development. The system that emerged focused on profits as presented in the income statement. There was no requirement to classify assets and liabilities as either current or not current. Balance sheets, in general, were not especially emphasized.[6] In fact, in contrast to the "asset" definition under U.S. GAAP (and similar accounting systems) that emphasized "control" over "future economic benefits," "assets" under China's Accounting Law were defined simply as "economic resources, which are measurable by money value."[7] Perhaps as a consequence of weak balance sheet development, owner's equity contributions were allowed to be counted as income. Additionally, there were no provisions to furnish consolidated financial statements (as they are understood in U.S. GAAP or IFRS), so consolidated reports (if any) were prepared under an equivalent of the equity method.[b] Expenditures on capital investments were divided into initial and subsequent expenditures. Subsequent expenditures were capitalized only when they improved the condition of the asset beyond its originally assessed standard of performance.[8] This made it difficult for companies with heavy maintenance costs to capitalize such costs.

Attempts to modernize the accounting system did not always go smoothly. In 1997, China introduced debt restructuring guidelines that were more in line with international practice. Consequently, when debts were restructured, any gain was countable as a source of profit on the income statement. Companies saw this as a way to inflate profits and skirt regulatory restrictions. This prompted the Ministry of Finance (MOF) to act in 2001 to prevent such practices. It required that earnings gained from debt restructuring be included in capital reserves. The change resulted in a number of bankruptcies.[9]

By 2009, there were more than 10 million accountants in China, but skill levels varied enormously. At large SOEs, banks, and listed companies, most accountants were graduates of competitive universities and upheld relatively high professional standards. Accountants at small and medium-sized enterprises were generally somewhat less qualified. Similarly, China had over 5,600 professional accounting firms, but only 70 were authorized to audit listed companies. This business was monopolized by the local offices of the "Big Four" accounting firms, which had first set up offices in China in the early 1990s.[10]

China was trying to build up its domestic accounting industry to counter the international firms' dominance. By 2016, it hoped to have at least 10 domestic accounting firms offering comprehensive international standards of service, and an additional 100 firms that could serve large domestic enterprises.[11] This was to be achieved in part by merging existing firms into larger ones.

[b] Under the equity method, the investor records the investment at acquisition cost and subsequently makes adjustments to this value for the investor's share of the investee's earnings. Such adjustments flow through the investor's income statement. Positive earnings in the investee increases investor net income and the book value at which the investment is carried; while dividends received from the investee and investee losses reduce net income and investment book value.

Enforcement Issues

China's Ministry of Finance was authorized to promulgate and enforce accounting standards and provide guidance and opinions on implementation. (See **Exhibit 5** for a chart of China's accounting regulatory authorities.) An advisory body, the China Accounting Standards Committee, provided recommendations on setting and improving accounting standards. China's National Audit Office was responsible for accounting oversight at the largest SOEs. Cases of accounting fraud were turned over to the police and judiciary for prosecution.

When Chinese enterprises first began selling shares during the 1980s, all equity and debt transactions were monitored by the People's Bank of China. By 1992, more companies were looking to sell equity, and the China Securities Regulatory Commission (CSRC) was created that year. However, empowering legislation for the CSRC's regulatory authority—a new Securities Law—was not passed until 1998 and came into effect only in July 1999.

From the very beginning, the CSRC reported to a ministry-level entity known as the State Council Securities Committee,[c] made up of senior Chinese leaders and chaired by the vice premier. Initially, the CSRC was responsible for drafting regulations, overseeing and supervising entities involved in the securities business, supervising companies that issued securities, and compiling statistics and market analyses. It also played an enforcement role for listed companies and began taking steps to improve corporate governance and crack down on fraud in the stock markets.[12] Once the Securities Law took effect in 1999, the CSRC was quickly able to consolidate its authority and establish branch offices across China. New disclosure and accounting standards were introduced in 1999 to improve transparency and financial reporting. Beginning in 2001, listed companies were required to issue quarterly financial statements in addition to annual reports.[13]

In practice, the enforcement of accounting standards across China was weak. A 2000 State Auditing Bureau investigation of accounting practices at over 1,200 state-owned enterprises found that about 68% of these companies had "serious" accounting falsifications. However, in the period between 1981 and 2001, only about 10 accountants in all of China had received life suspensions for malpractice.[14]

China was slow to adopt tort remedies for financial crimes. The first successful civil lawsuit against a company for damages resulting from a false financial statement was decided in mid-2004.[15] The objectivity of China's courts in applying securities laws was also questionable. In a study critical of China's accounting enforcement, Sweden-based China scholar Sonja Opper noted, "Political interests prevail over legal justice, if they reach disparate conclusions. In general, Chinese courts always consider whether ruling on a case will provoke social instability if shareholders file a suit."[16]

Market-based enforcement institutions such as an active financial press, while present in China, had to tread carefully in doing their work. In a high-profile case in 2002, a Chinese court found the business magazine *Caijing* guilty of defamation after it reported on investigations into possible insider trading and accounting fraud by listed companies. Reacting to the case, Opper noted, "The procedure and outcome of the lawsuit . . . eventually could undermine the position of China's financial media."[17]

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[c] The State Council was the highest executive-level organ of the Chinese government.

Restatements

The Ministry of Finance began to require companies that discovered material accounting errors in prior periods to issue restatements only in February 2006. Before this date, listed companies were not required to restate earnings immediately upon discovery of accounting errors. Instead, errors were dealt with by means of presenting "corrected" information in subsequent financial statements. In response to serious problems with the timely release of corrected financial information by listed companies, the CSRC issued a notice in January 2004 requiring "companies that discover accounting errors [to] release corrected information in the form of a provisional announcement of significant items . . . ."[18]

IFRS Convergence

As part of a World Bank-funded project that began in 1993, China's Ministry of Finance hired consultants from some of the "Big Four" to help devise new accounting standards. The result was a set of 16 standards introduced between 1997 and 2001 and collectively known as the "China Accounting Standards" (CAS).

By 2005, China]s economy continued to post strong growth, but it relied heavily on manufacturing and infrastructure construction. China hoped to expand its service industry sector. Converging with IFRS was seen as a way to help China's domestic accounting firms develop and internationalize. It was also regarded as a way to improve the cross-border comparability of financial statements, and thus help Chinese companies that sought to list or to attract investment abroad. Hong Kong had fully converged its accounting standards with IFRS on January 1, 2005, so Chinese companies listed on the Hong Kong market were already preparing statements based on IFRS.[19]

In February 2006, China's Ministry of Finance and the IASB announced an understanding whereby China's accounting standards were to "converge" with IFRS. Later that month, the Ministry of Finance released its Accounting Standards for Business Enterprises (ASBE), and made ASBE compliance mandatory for all listed companies beginning January 1, 2007. With a few notable exceptions, the ASBE were similar to IFRS. It was a dramatic move for China to make in such a short period of time. IFRS convergence was widely seen to be driven by senior leaders who sought both to ensure continued economic growth and to enhance China's international status.

Moving to IFRS was also thought to be a way for China to address some of the many anti-dumping actions brought against it. WTO (and formerly GATT) rules considered a product to be "dumped" when its export price was less than either the price charged for a similar product in the exporting country or the cost of its production. If investigations revealed that dumping by an exporter caused "serious injury" to a country's domestic industry, the rules allowed the aggrieved country to take safeguard actions such as restricting imports for temporary periods. The first dumping case against China was initiated in 1979, soon after the country began to open up its economy. From 1995 to 2008, over 20% of all global anti-dumping measures were targeted at China.[20]

Low wages and government support for state-owned industries made China an easy target for dumping complaints. Moreover, since China was still designated a nonmarket economy by the WTO, anti-dumping actions against it faced a lower bar. For example, when establishing a dumping claim against China, the aggrieved country did not have to rely on Chinese accounting data to establish cost of production; it could instead use data known as "constructed values" based on accounting information from third-party exporters or producers.[21] Some observers saw convergence with IFRS as a way for China to head off some dumping complaints by improving the credibility of Chinese companies' financial statements. Under IFRS, foreign governments and courts could more easily understand and interpret Chinese companies' manufacturing costs. Thus, IFRS adoption was a potential means to reduce international trade conflict and its associated costs on Chinese exports.[22] However, China's low wage structure meant that dumping problems were likely to persist despite accounting changes.[23]

China's move to IFRS-based standards had already involved incurring substantial costs. Chinese accounting systems had historically focused on the income statement. Likewise, Chinese investors were accustomed to relying mostly on profit indicators: Reviews and approval systems—including those for listing, delisting, and sanctions—were mainly focused on reported income measures. IFRS, in contrast, placed more emphasis on the balance sheet. From the Chinese regulators' point of view, a key consideration in moving from an emphasis on the income statement to what they called a "balance sheet orientation" was to encourage companies to "aim to improve the quality of their assets and liabilities."[24] But it had been hard to change the mindsets of companies as well as market participants. To help companies adjust to the new reality, the Ministry of Finance introduced new rules. For example, it clarified that proceeds and losses from financial assets for sale, changes in fair values, and adjustments in owners' equity from transactions between shareholders were to be accounted in "consolidated income" and not "net income."[25] An even more tangible measure involved changing the tax rules. "Previously, taxation was based on the income statement," the chief CSRC accountant explained. "Now it's based on the balance sheet."[26]

While China had said that it eventually hoped to adopt IFRS in their entirety, the new ASBE were substantially different from IFRS in some key areas, as outlined below. Chinese regulators insisted that the country's "unique circumstances" precluded the direct adoption of IFRS. Given the economic environment in China and the country's emerging-market status, it made more sense to "converge" China's standards with IFRS. Regulators took pains to point out that this was different from "direct adoption" of IFRS.

Related-Party Disclosures

When China signed the IASB convergence statement in 2005, a key issue for China had been related-party disclosures. China's largest companies still had considerable state ownership. According to IAS 24, all SOEs were considered related parties, and all of their transactions were related-party transactions. In China, this was simply unworkable. For a state-owned company to disclose all its related-party transactions "would require thousands of pages," one Chinese regulator said.[27]

China argued that despite the state's ownership stakes in these enterprises, they still operated independently, paid taxes, and faced competitive pressures. If two enterprises had an investment connection, China agreed to classify them as related parties, but not if the only thing they had in common was state ownership. A complicating factor was that in China, the party that exercised effective control of a company was not always the largest shareholder. As a remedy, Chinese listed companies were required to declare the controlling party beginning in 2004.[28]

China wanted a full exemption for state enterprises from the related-party provisions of IFRS, and hoped to persuade the IASB to accept this view. But indications were that the IASB was only willing to entertain partial exemptions.[29]

Fair Value Accounting

Another area where Chinese regulators were hesitant to adopt IFRS in their entirety was fair value accounting. Manufacturing led China's economic growth, and the financial industry was still underdeveloped relative to the size of its economy. It was hard to determine fair value on a continuing basis for many capital assets in the economy.[30] Both financial instruments and the level of financial innovation were relatively unsophisticated. For example, as of 2009, margin trading was not yet allowed in China. Moreover, China still maintained strict controls on its capital account, impeding capital asset liquidity. Companies and private individuals were restricted in the amount of capital they were able to send overseas, and all but the smallest in-bound foreign investments were subject to government approval.

A senior official at one of China's domestic stock exchanges opined that a very important factor in deciding whether to adopt IFRS criteria for fair value accounting was the nature of the companies and industries that made up the capital markets.[31] If many financial institutions were in the capital markets, then fair value was beneficial; however, manufacturers were the main capital market participants in China, so fair value accounting was as yet unnecessary, the official observed.[d] In fact, some Chinese regulators believed that one reason China did not face more serious losses during the 2008–2009 financial crisis was that fair values played only a minimal role in its system. "With fair value, the key is in the implementation," the stock exchange official added. "We are conservative because we don't have the right environment and cannot find reliable references for fair value."[32]

Another issue was that the application of fair value—especially in assets with illiquid markets—required an evaluation report from a third party; and a third-party report was a costly recurring fee. In addition, it was believed that China's domestic accounting firms were not capable of preparing these evaluation reports, so companies had to rely on international accounting firms for this service.[33]

Impairments

Before ASBE, Chinese accounting standards did not allow for the reversal of impairments (much like U.S. GAAP). Although ASBE, like IFRS, allowed for some reversal of impairment, this made Chinese regulators uncomfortable, particularly with regard to short-term and intangible assets. Chinese investors paid considerable attention to the income statement, and both a company's qualification to list an IPO and delisting provisions depended almost entirely on reported profits. This gave companies a motive to use impairment losses to manipulate profits.

In some cases, a company recorded profits by increasing impairment losses significantly in one year and then reversing them in the next. For example, in 2001, Kelon Electrical Holdings Company Ltd. posted a loss of RMB 1.5 billion. The following year, it reversed RMB 50 million in bad debt provisions and another RMB 212 million in inventory depreciation provisions. This reduced expenses and helped the company post profits of RMB 100 million for 2002.[34] Monitoring such practices was a tremendous cost for capital market regulators.[35]

For now, China's regulators were willing to allow impairment reversals on certain long-term fixed assets. Current assets and financial assets such as loans or accounts receivable could also be recovered, and thus, ASBE permitted some impairment reversals there as well. Even so, Chinese regulators hoped to retain their ability to make adjustments to accounting standards in "special cases," when the need arose.[36]

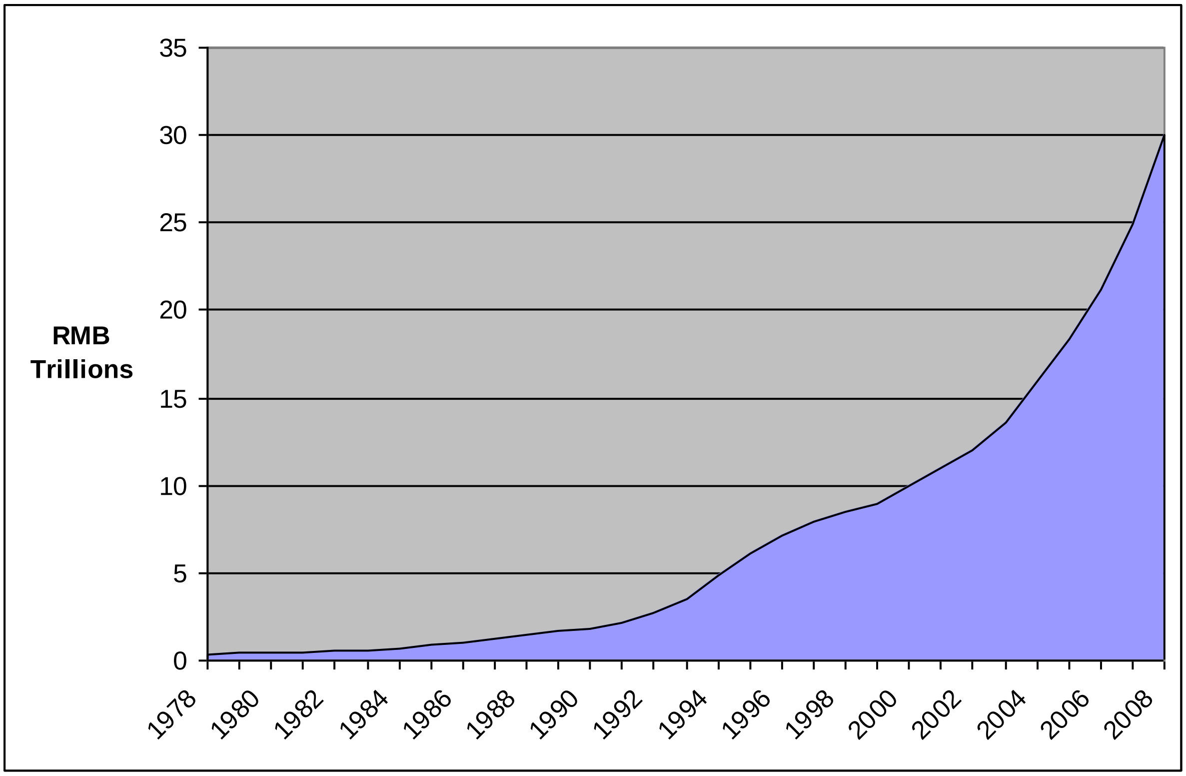
[d] Of the 1,624 listed companies on China's two stock exchanges, only 27 were financial institutions.

Convergence: In Which Direction?

After mandatory adoption of ASBE by China's listed companies began in 2007, state-owned companies controlled by the central government and a number of other large companies had also adopted ASBE.[37] The Ministry of Finance further projected that all large enterprises in China were going to be using the new IFRS-convergent standards by 2010 or at the latest, by 2011. Additionally, small and medium-sized enterprises (SMEs) had begun implementing an "accounting standards system for small enterprises." China planned to integrate elements of the most recent IASB standards for SMEs into its own system.

While China had committed to "substantial convergence" with IFRS, there were still considerable differences that had to be negotiated. Chinese regulators believed they had sound arguments for their positions, and were confident that the IASB was going to meet them halfway on some of the more difficult issues. The Ministry of Finance pointed out that on the issue of related parties, the IASB had already agreed to change IAS 24 in line with some of China's concerns about its SOEs. (See **Exhibit 6** for a timeline of the events leading up to the IASB's modified position on related parties and **Exhibit 7** for the IASB's press release on the issue.) China was slowly moving toward the international standards, it was thought, but at the same time there were indications that the international standards were slowly moving toward China.

Exhibit 1 China GDP Growth, 1978–2008



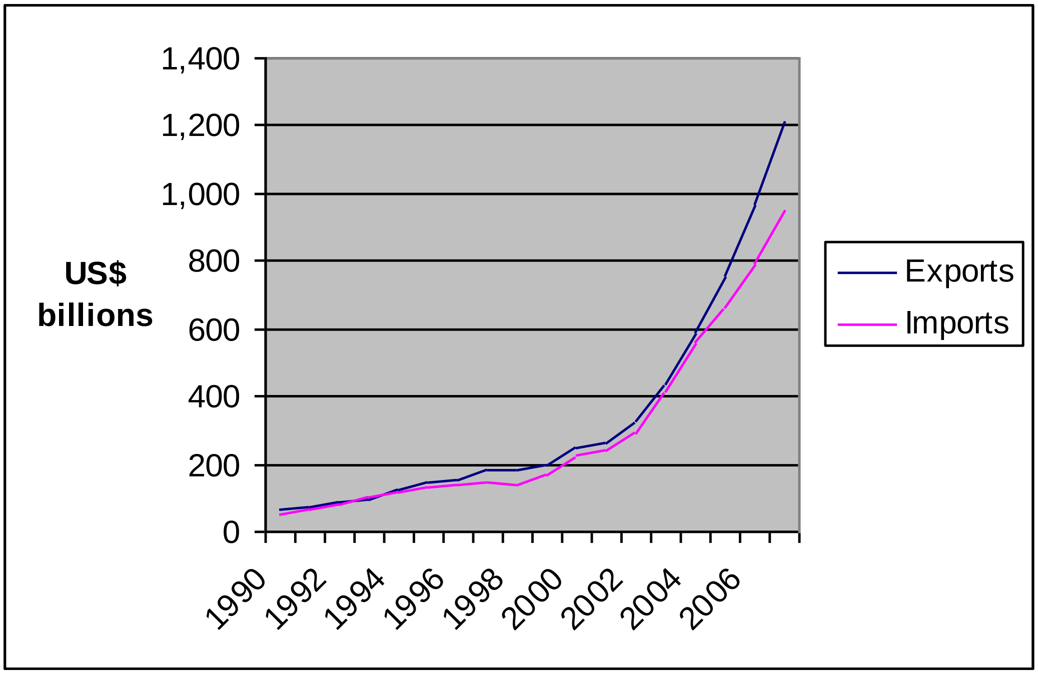
Source: China National Statistics Bureau.

Exhibit 2 Chinese Companies in the Global Fortune 500 (2009)

	Company	Global 500 Rank	Revenues (US$ millions)
1	Sinopec	9	207,814
2	China National Petroleum	13	181,123
3	State Grid	15	164,136
4	Industrial & Commercial Bank of China	92	70,568
5	China Mobile Communications	99	65,015
6	China Construction Bank	125	57,977
7	China Life Insurance	133	54,534
8	Bank of China	145	51,317
9	Agricultural Bank of China	155	48,063
10	Sinochem	170	44,457
11	China Southern Power Grid	185	41,083
12	Baosteel Group	220	35,517
13	China Railway Group	242	33,758
14	China Railway Construction	252	32,538
15	China Telecommunications	263	31,814
16	China State Construction Engineering	292	29,807
17	China National Offshore Oil	318	28,027
18	China Ocean Shipping	327	27,430
19	China Minmetals	331	26,667
20	COFCO	335	26,446
21	China Communications Construction	341	25,983
22	Shanghai Automotive	359	24,882
23	Sinosteel	372	24,164
24	Hebei Iron & Steel Group	375	24,034
25	China Metallurgical Group	380	23767
26	China FAW Group	385	23664
27	Citic Group	415	22229
28	China United Telecommunications	419	21981
29	China Huaneng Group	425	21781
30	Aviation Industry Corp. of China	426	21738
31	China South Industries Group	428	21675
32	Jiangsu Shagang Group	444	20897
33	Bank of Communications	494	18677
34	Aluminum Corp. of China	499	18579

Source: Adapted and compiled by casewriter using information from *Fortune*, July 20, 2009, http://money.cnn.com/magazines/fortune/global500/2009/countries/China.html, accessed September 2, 2009.

Exhibit 3 China's Balance of Trade, 1990–2007



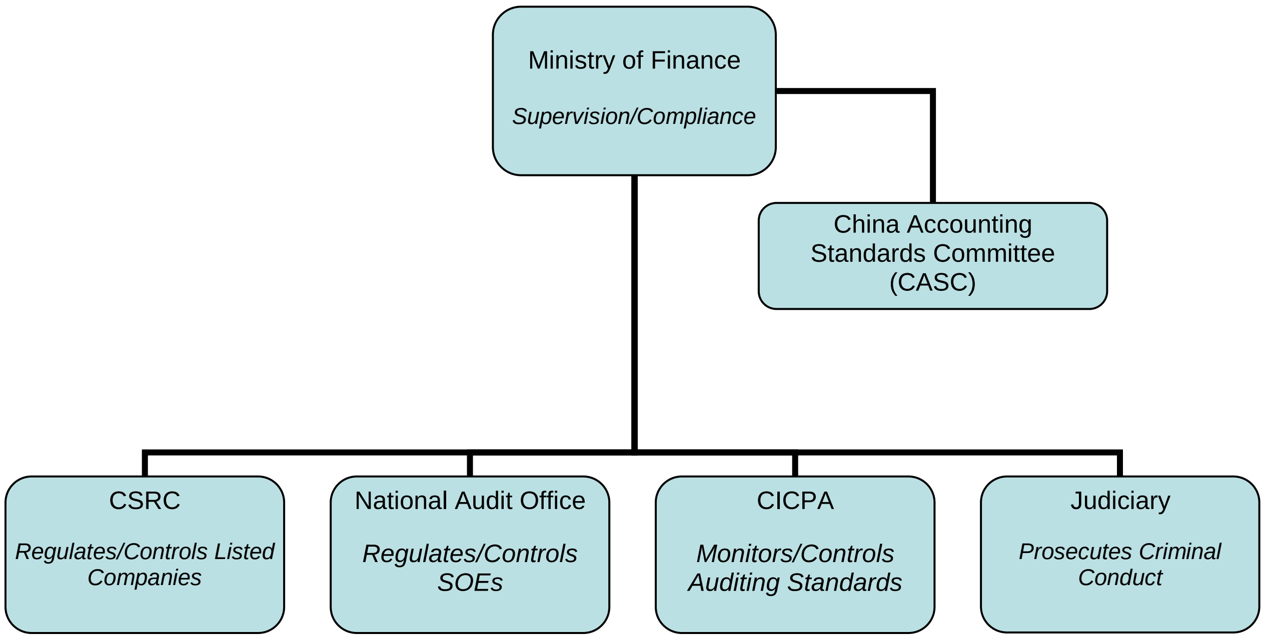
Source: China National Statistics Bureau.

Exhibit 4 Market Capitalization of Largest Chinese Companies on the NYSE

Company	Market Capitalization (US$ million)
Petrochina	368,941
China Mobile	192,913
CPCC	123,116
China Life	114,315
CNOOC	52,862
China Telecom	40,309
China Unicom	30,088
Aluminum Corporation of China	20,758
Huaneng Power	12,432
Yanzhou Coal Mining	9,448
Total (65 companies)	1,099,745

Source: NYSE Euronext Factsheet, "NYSE Euronext and Greater China," June 2009, http://www.nyse.com/pdfs/NYSEEuronext_China_factsheet-CN.pdf, accessed September 2, 2009.

Exhibit 5 Regulation of China's Accounting System



Source: Casewriter.

Exhibit 6 IAS 24 Timeline

Prior to 2003, state-controlled entities were exempt from IAS 24's related party disclosure requirements. That exemption was removed in a 2003 revision which specified that profit-oriented state-controlled entities that use IFRS must disclose transactions with other state-controlled entities. In jurisdictions such as China, where state-controlled entities are a major segment of the economy, the volume of disclosures under the requirements of IAS 24 became burdensome and unwieldy, impairing the understandability and usefulness of financial statements.

Feb. 2006 China MOF and IASB announce plans to converge Chinese accounting standards with IFRS; MOF issues new ASBE.

May 2006 IASB agrees to begin consultations on clarifying IAS 24 requirements for transactions between entities with significant state ownership.

Feb. 2007 IASB releases draft of proposed amendments to IAS 24; the amendments 1) exempt some state-controlled entities from related party disclosures, and 2) change the definition of related party; comment period limited to 90 days in hopes that the amendment could be in place before the end of the 2007 financial year.

Oct. 2007–Jan. 2008 During IASB discussions, the proposed changes become increasingly complicated; talks end "in a degree of confusion" after the board determined:

> in some jurisdictions including China, the State often nominates one or more Board members. This fact alone seemed to indicate that the State would normally 'participate in the operating and financial decisions' of State-controlled entities and thus would always fail the exemption criteria.

Sep.–Nov. 2008 Deciding that current proposals were too complex, the IASB formulates a new approach whereby related party transactions of state-controlled entities need not be disclosed, but instead general disclosures about the types and extent of significant transactions would be required.

Jul. 2009 IASB tentatively approves changes to IAS 24, effective Jan. 1, 2011; plans to issue new standard in Nov. 2009. The changes 1) provide a partial exemption for disclosure by government-related entities, and 2) simplify the definition of a related party.

Nov. 4, 2009 IASB issues revised version of IAS 24 [see **Exhibit 7**].

Source: IAS Plus, IASB Agenda Project, Deloitte Touche Tohmatsu, http://www.iasplus.com/agenda/relatedparty.htm, accessed November 6, 2009.

Exhibit 7 IASB Press Release on Revision of IAS 24, November 4, 2009

International Accounting Standards Board®

Press Release

4 November 2009

IASB simplifies requirements for disclosure of related party transactions

The International Accounting Standards Board (IASB) issued today a revised version of IAS 24 *Related Party Disclosures* that simplifies the disclosure requirements for government-related entities and clarifies the definition of a related party. The revised standard is effective for annual periods beginning on or after 1 January 2011, with earlier application permitted.

IAS 24 requires entities to disclose in their financial statements information about transactions with related parties. In broad terms, two parties are related to each other if one party controls, or significantly influences, the other party.

The IASB has revised IAS 24 in response to concerns that the previous disclosure requirements and the definition of a 'related party' were too complex and difficult to apply in practice, especially in environments where government control is pervasive. The revised standard addresses these concerns by:

- **Providing a partial exemption for government-related entities.**

  Until now, if a government controlled, or significantly influenced, an entity, the entity was required to disclose information about all transactions with other entities controlled, or significantly influenced by the same government. The revised standard still requires disclosures that are important to users of financial statements but eliminates requirements to disclose information that is costly to gather and of less value to users. It achieves this balance by requiring disclosure about these transactions only if they are individually or collectively significant.

- **Providing a revised definition of a related party.**

  The IASB has simplified the definition and removed inconsistencies.

The document IAS 24 *Related Party Disclosures* is available for eIFRS subscribers from today.

Printed copies of IAS 24 *Related Party Disclosures* (ISBN 978-1-907026-41-6) will be available shortly, at £15 plus shipping, from the IASC Foundation Publications Department.

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Source: International Accounting Standards Board, http://www.iasb.org/News/Press+Releases/IASB+simplifies +requirements++for+disclosure+of+related+party+transactions.htm, accessed November 6, 2009.

Endnotes

[1] "World Growth Grinds to Virtual Halt, IMF Urges Decisive Global Policy Response," *IMF Survey Online*, January 28, 2009, http://www.imf.org/external/pubs/ft/survey/so/2009/RES012809A.htm, accessed October 12, 2009.

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[8] Deloitte, "China's New Accounting Standards," p. 13.

[9] Casewriter interview with Shenzhen Stock Exchange representative, Shenzhen, June 30, 2009.

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