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Accounting Choice in Listed Companies of China

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Abstract

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Key words: accounting choice, historical cost accounting, fair value accounting

Purpose: Our aim is to explain the factors that influence the accounting choice of listed companies in China between the historical cost accounting and fair value accounting during the transitional period.

Methodology: This thesis has a deductive approach. Since accounting choice is a classical subject, those existing theories could be applied to explain China's case according to amounts of empirical researches and articles.

Theoretical Perspectives: Positive accounting theory and institutional theory are applied to build our hypotheses. Share market, ownership, financial difficulties, industry, size, auditing firm and foreign list are predicted to explain the accounting choice of listed companies in China.

Empirical Foundation:

We set accounting choice as dependent variable while share market, ownership, financial difficulties, industry, size, auditing firm and foreign list as independent variables. We test our hypotheses based on Wind Database and financial reports of 1841 listed companies in 2007. And the empirical test shows that share market, industry, size, auditing firm and foreign list are significant variables, as we predicted. However, there are no significant correlations between accounting choice with ownership and financial difficulties.

Conclusions: During the transitional period, most listed companies in China chose historical cost accounting rather than fair value accounting. According to our empirical test, share market, industry, size, auditing firm and foreign list are significant factors to explain the accounting choice while both of ownership and financial difficulties variables have no significant relationship with the accounting choice. Also, some other potential factors have been discussed and suggested in the future research.

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Abbreviations

FASB Financial Accounting Standards Board

IASB International Accounting Standards Board

IFRS International Financial Reporting Standards

US GAAP Generally Accepted Accounting Principles in the United States

CPC Communist Party of China

SFAS Statements of Financial Accounting Standards

FDI Foreign Direct Investment

ASBE Accounting Standard for Business Enterprises

WTO World Trade Organization

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Chapter I Introduction

1.1 Background

Since the financial crisis of the 1980s and frauds like the cases of Enron and WorldCom, a discussion has been started about the accounting measurements due to different characters. Financial troubles have been caused among financial institutes due to the transaction about the financial instruments (Li, 2007) under the historical cost measurement. Since then, fair value measurement has attracted more and more attention by the users and the rule making authorities around the world. Increasing countries are striving to transform from historical cost accounting towards fair value accounting. In 2005, FASB issued SFAC no. 157 to establish a framework of fair value measurement in US GAAP. In 2006, the Ministry of Finance of China published "Accounting Standard for Business Enterprises", which represented that China's accounting practice is convergence to IFRS. Moreover, as an international initiative, IFRS, considering its core fair value, has achieved impressive progress until now. In March 2009, 85 countries had adopted IFRS and additional countries permit the use of these standards. (Tribunella, 2009)A total of 113 countries either require or permit the use of IFRS and there will be more to come. (Tribunella, 2009) So far, the scope of application of fair value is expanding globally.

When we emphasize on China's case, it is of interest to discuss the accounting choice of the listed companies. According to the "Accounting Standard for Business Enterprises" published in 2006 by the Ministry of Finance of China, listed companies were required to apply fair value measurement on 1st January, 2007. However, as the traditional accounting measurement, historical cost accounting has been used for years and it is difficult for both listed companies and professional accountants to switch to fair value accounting immediately. (Ying, 2008; Su, 2008; Wen, 2008; Songsheng, 2009) Of note, state-owned companies are required to use fair value accounting gradually from 1st January, 2008. (Ying, 2008; Wen, 2008) Thus, there was a transitional period for listed companies to transfer from historical cost accounting to fair value accounting, which led to an accounting choice problem. According to Ying's (2008), during 2007, the first year of implementation, most listed companies in china shown prudent accounting principles while chose the accounting measurement. Since the state-owned companies are required to use fair value in 2008, which led the accounting choice problem no longer exist expect special circumstances, we choose 2007 as our sample. Across the whole sample of 1841 listed companies in 2007, different accounting choices were made. Some listed companies stick to historical cost accounting while others chose the path of fair value accounting.

According to the mechanistic view of accounting choice, accounting is a monopoly source of information about firms. (Holthausen and Leftwich, 1983) And accounting choices have economic consequences if changes in the rules used to calculate accounting numbers alter the distribution of firms' cash flows, or the wealth of parties who use those numbers for contracting or decision making. (Holthausen and Leftwich, 1983) Since the different economic consequences of the accounting choice could lead to, questions are raised as follows. How did listed companies choose the accounting measurement during the transitional period? When there existed a voluntary choice between historical cost measurement and fair value measurement, depend on what factors did the listed companied make their accounting choice? We choose 2007, the first year of the implementation of fair value, as our empirical study sample to exam our hypotheses and try to explain the factors that influence the accounting choice of listed companies in China.

1.2 Concepts of Historical Cost Accounting and Fair Value Accounting

1.2.1Historical cost accounting

Historical cost is the original monetary value of an economic item (IFRS, 100), which is based on the past real transaction and does not reflect the current market value. Historical cost measurement, as a traditional accounting model, is not only simple to be applied but also relatively objective, reliable and verifiable (Matis and Mustata, 2004). As Matis and Mustata (2004) stated, the objective of the historical cost comes from its capacity to reflect the real information of the transaction in time since it has at its base events that already happened. Also, the reliable objective is owing to the ability that historical cost measurement can deliver correct information in time. Furthermore, historical cost only accounts for the initial cost. Once settled, no matter how the environment has changed, it remains fixed. Thus, it is easier to get the information and the process is simple. Besides, historical cost measurement does not require too much professional judgments from accountants, which means it is verifiable and cost-saving.

However, criticisms have been arisen by opponents (Zhao, 2007; Gu, 2009) through the implementation of historical cost accounting. First, sometimes, it is hard to obtain the historical cost records of assets and liabilities, which occurred with the development of economy and technology. For example, due to the characters of the derivative financial instruments, it is very difficult to obtain the historical cost records in the beginning of the transaction. Second, the deviation between historical cost and current value, contribute to the distortion of the historical cost. The information of historical cost could not reflect the real value of the assets and liabilities in some special circumstance (Zhao, 2007). Especially, the financial instruments like stock, bond and exchange rate are floating everyday. Moreover, the inflation or deflation would result in the rise or down of the overall value. Third, historical cost measurement lacks relevance, which would not reflect the real performance of the company, and destroy the equity of the stakeholders. As a serious deviation from the current market value, the historical cost loses its decision relevance, which could affect the users of accounting information to make an inappropriate decision.

1.2.2 Fair Value Accounting

The definition of fair value issued by FASB in SFAC no. 157 states that "Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date."(Hitz, 2007) According to the definition, four perspectives could be analyzed. First, it emphasizes the "orderly transaction", which assumes that the transaction market exists before the measurement date. The transaction is a hypothetical transaction, and also it is voluntary instead of being forced (SFAS 157, 7). Second, this concept of fair value emphasizes the "market participants" are the parties who are independent with each other, and have the knowledge of the transaction, also with the ability to do the business in a economically rational way (SFAS 157, 10). Third, it emphasizes the "measurement date" which means that the price is not exist in the past period or future period. Forth, fair value assumes that the relevant markets are perfect and complete (Whittington, 2008).

Compared with historical cost accounting, which is oriented to the past, the fair value accounting is towards the further, forecasting future cash flows to satisfy the need of those current and prospective investors and creditors (Whittington, 2008). Moreover, fair value accounting improves the comparability of the accounting information to provide useful information for the users to do the economic decision (Matis and Mustata, 2004). Besides, relevance is a primary character of fair value (Khurana and Kim, 2003). Nevertheless, lacking of reliability is the main disadvantage of fair value accounting. Fair value measurement is based on the current price which may require the accountants to estimate. It could lead to reliability problems due to different factors would affect the estimation (Khurana and Kim, 2003).

1.3 The purpose and the problem statement

According to “Accounting Standard for Business Enterprises”, the latest 2006 version, the criterions of fair value measurement are strict and in order to avoid the situation that some enterprises use fair value to add virtual profits. Also, the traditional historical cost accounting has been used for years, which make it impossible to implement fair value measurement in listed companies immediately. Thus, there was a transitional period; existing voluntary and mandatory choice could be applied. Sometimes, listed companies could choose from the two accounting measurements, which raised an accounting choice problem among enterprises. Our research is based on the data in 2007, the first year of the implementation of fair value in China. And our research aim is to explain the factors that influence the accounting choice made by listed companies in China between historical cost accounting and fair value accounting.

Chapter one of the dissertation introduce the related concepts, background and our purpose. In the second chapter we applied deductive research approach and use positive accounting theory together with institutional theory as our theoretical methods. Background of accounting system in China and the factors that influence China's accounting practices will be introduced in section three. In chapter four the theory found, and used, is presented, followed by the hypotheses. Hypotheses will be drawn to indicate the factors that influence the accounting choice used by listed companies in China. The fifth chapter contains variables and how we collect the data. In chapter six, an empirical analysis will be presented and results will be draw based on the empirical test. Chapter seven represents the conclusion of the findings, implications, criticism towards the dissertation and suggestions for further research.

Chapter II Method

2.1 Research Approach

Based on the aim of the thesis, in order to explain the factors that influence the accounting choice of listed companies between historical cost accounting and fair value accounting, we are considering two broad methods of reasoning as the deductive and inductive approaches, which are often referred to by the researchers. The deductive approach is based on existing theories and earlier empirical observation to test a hypothesis. In contrast, the inductive approach is conducted without any former expectations.

In general, the inductive approach is mainly used when there is little or no theory to exist in the research field, or the researchers believe that they will find the different results according to the empirical analysis. Due to accounting choice is a classical subject, there are many theories existing and amounts of empirical research and articles we could apply to explain the factors influence accounting choice of listed companies in China. Therefore, we prefer a deductive approach rather than an inductive approach. We choose both positive accounting theory (PAT) and institutional theory (IT) as our theory approaches, which have been supported by many empirical literatures. Especially, we found China's case shares similar characters comparing with the empirical article of Collin et al. (2009), which focused on explaining the choice of accounting standards in municipal corporations in Sweden. Both of the two papers are aiming to explain the factors that influence of the accounting choice, although focus on different countries. Thus, following the successful explanation of the accounting choice in municipal corporations by Collin et al. (2009), we want to test the theories whether they are suitable in China to explain the accounting choice of listed companies.

2.2 Theory Approach

According to the new accounting standards, listed companies began to adopt the fair value measurement. Before the punishment of the new accounting standards, scholars worried that the managers would use fair value to add virtual profits. However, based on the interim financial reports in 2007 from the Wind database, only a few listed companies used fair value measurement. Stressing the fundamental differences between the two opposing alternatives, fair value measurement or historical cost measurement, we state our question: what factors could influence and explain listed companies' accounting choice between fair value accounting and historical cost accounting?

Many scientific literatures have provided empirical support on accounting choices based on positive accounting theory (PAT) (Dumontier and Raffournier, 1998; Missonier-Piers, 2004) and institutional theory (IT) (Meyer and Rowan, 1977; Zucker, 1987). Given our aim to explain accounting choice in listed companies, we are confronted with the choice of PAT or IT. Which theory should we choose?

Positive accounting theory is a theory which contains large samples and statistical testing on data which are from capitalistic, preferably listed corporations has a nomothetic orientation (Inchausti, 1997; Meyer et al., 2000; Bradshaw et al., 2004). PAT appears to be an appropriate theory to explain listed companies' accounting choice since an agency problem probably exists. The basic assumption of agency theory is that it is based on self- interest (Falkman and Tagesson, 2008), which could explain the managerial behavior. Derived from agency theory, positive accounting theory provides a framework for explaining and predicting accounting choice (Watts and Zimmerman, 1990; Jensen, 1976). Following the paper wrote by Watts and Zimmerman in 1978, contracting costs (including information, agency, bankruptcy, and lobbying costs) were emphasized when concerned with explanation of accounting. As Watts and Zimmerman (1990) stated, accounting choice is influenced by the achievement of the individual objectives. Furthermore, managers make accounting choices that advance their own narrow self-interest, constrained by employment contracts, debt contracts, and the political environment. (Knoeber and McKee Jr., 1991) Thus, the contracting parties (Watts and Zimmerman, 1990) or the managers of listed companies would prefer the accounting measurement to achieve the maximum of their own wealth (Williams, 1989), especially when there is an bonus plan present.

Besides the individual perspective, PAT also focuses on shareholder aspect of accounting system, predicting the choice of accounting rules according to the wealth effects it has for influential stakeholder. (Watts and Zimmerman, 1986) Hence, it emphasizes agency conflicts. Due to the increasing requirements from the huge amounts of stakeholders and investors, listed companies need to provide more accounting information and disclosure. This could create conflicts of interest in which accounting choice could be a factor. Since the fair value measurement could reflect in the income statement of the financial reports, the fluctuation of the market price could increase the risks of shareholders and investors. Therefore, the monitoring from the shareholders could put pressure on managers to choose the accounting measurement which could maximize the profits and reduce the risks of shareholders.

A second theoretical viewpoint is institutional theory (Meyer and Rowan, 1977; Zucker, 1987), which assumes that organizations respond to pressures from their institutional contexts and adopt structures and practices from their institutional contexts, the appropriate socially accepted organizational choice and considered legitimate by other organizations in their fields. (Falkman and Tagesson, 2008) Institutional theory focuses on the relationship between organizations and the environment. It consists of economical, political, and sociological elements, such as culture, laws, norms, taxpayers, government and various public interest groups (Scott, 1995; Handelman and Arnold, 1999). Therefore, the organizational decisions and behavior would be affected by the institutions. Moreover, IT explains accounting choice by taking into account the different organizational actors and the different types of organizational pressure they face; be it normative, coercive, or mimetic in nature (DiMaggio and Powell, 1983; Collin et al., 2009) As a result, IT appears to be an appropriate theory for listed companies to explain the accounting choice due to the pressures from different isomorphism.

Isomorphism is coercive, which means that the organization would be inflicted by pressure from the external organizations. (Falkman and Tagesson, 2008) Political and legal factors, considered as special institutions due to the dominant power of China's government, would influence the accounting choices of listed companies between fair value and historical cost measurement. In order to satisfy the requirements of investors and stakeholders, Financial Ministry issued the new accounting standards in 2006. Listed companies are required to follow the strict criterion of fair value measurement.

"Mimetic is an imitation by modeling successful concepts in order to manage uncertainty"(Falkman and Tagesson, 2008). Usually, successful experiences are more likely to be imitated. Fair value accounting has been widely accepted around the world. Due to business globalization and accounting harmonization, the rapid economic development and the special market economics system of China would reflect on the accounting choice by the global trend of fair value accounting.

Normative mechanism, gives priority to moral beliefs and internalized obligations as the basis for social meaning and social order (Scott and Christensen, 1995). The organizational behavior is not only based on self-interest and expedience, but also an awareness of one's role in a social situation. (Scott, 1995) Norms in society is connected with Chinese culture, which could influence the accounting practices. Besides, the moral beliefs and internalized obligations are related to the professional judgments of the practitioners. Therefore, as DiMaggio and Powell (1983) pointed out, it was not always possible to distinguish the three mechanisms of isomorphic pressure from each other; two or more may be operating simultaneously, making it hard or even impossible to determine which mechanism of institutional pressure most strongly affects the institutionalization of accounting choice. (Falkman and Tagesson, 2008)

What should be the much proper approach to be used to explain the accounting choice in listed companies? According to the introduction and analysis of the PAT and IT above, both theories can be used to explain the accounting choice. However, the empirical literatures on accounting choice are prefer theoretical purity and are fragmented into two main, separate theoretical fields. (Falkman and Tagesson, 2008) Hence, which one is much better? Our aim is to explain the accounting choice of listed companies in China between historical cost accounting and fair value accounting. Since there are different stakeholders exist in organizations with varies interests groups, it is hard to explain the accounting choice based on one single theory. Further, both theories have the limitations in explaining the accounting choice. According to Watts and Zimmerman (1990), there are many unanswered technical and philosophical problems demonstrated within PAT which concerning research methods and methodology: (1) too negative and simplistic perspective of humankind; (2) only explains but not provide prescriptions and therefore does not provide a means of improving accounting; (3) the theory has not shown great development which still testing the same basic hypotheses; (4) the measurements and proxies are too simplistic. Meanwhile, IT also has its limitation. Kondra and Hinings (1998) addressed Powell's three major criticisms (1991) in IT: (1) an over-differentiation of the profit and non-profit sectors, (2) a failure to understand why less than optimal arrangement persist over time, and (3) a failure to address change within an institutional environment. (Kondra and Hinings, 1998) Due to these limitations of PAT and IT, it is hard to explain the accounting choice in China’s case only through one of them.

Therefore, we argue that IT and PAT can complement with each other in explaining accounting choice and using both of them is the rational choice for explaining the accounting choice (Collin et al, 2009; Tagesson et al, 2009; Mezias, 1990). PAT emphasizes the economic self-interests to explain listed companies' accounting choice. A basic assumption is that management incentives are a primary determinant of accounting choice. However, the accounting choice based on PAT generally ignores institutional pressures. Institutional theory is important in explaining accounting choice in organizations where self-interest maximizing actors cannot exert effective influence over the choice of accounting measurement because of their relative power positions in their organizations. (Carpenter and Feroz) Besides, according to Collin et al. (2009), IT contributes to PAT in two factors while PAT can support IT with two factors also. Thus, we believe using both PAT and IT to explain listed companies' accounting choice is the rational approach. We treated the theories separately and derive predictions about accounting choice from each other in Chapter four, just following the third section which introduced the China's special accounting environment and conditions. And then in section six, we used statistical method to test the hypotheses on an empirical sample of 1841 listed companies in 2007. The outcome emphasized the weaknesses and strengths of the different theories, also suggestions were formed in the seventh chapter.

Chapter III Accounting System in China

As for the accounting system of China, historical cost accounting is a traditional model. Fair value accounting has not been introduced into China until 1998. The reform of China's accounting system owing to the impressive economic growth and increasing foreign investments. The latest "Accounting Standard for Business Enterprises" published by the Ministry of Finance in 2006 shown that China's accounting practice is convergence to IFRS.

3.1 Four stages of fair value implementation

According to the implementation of fair value in China, it can be divided into four stages. The first stage is before the publishment of "Debt Restructuring" in 1998, there was no concept of fair value in accounting standards. The second stage is from 1998 to 2001, during which period fair value was introduced for the first time in China. The third stage is from 2001 to 2006. Within this period, due to the situation of economic market in China, the Ministry of Finance revised the former accounting standards and avoided the implementation of fair value. Fair value could be used only in limited situations. The foundation stone of the firth stage is "Accounting Standard for Business Enterprises", published by the Ministry of Finance in 2006, which comprises a complete accounting standard system including a basic standard and 38 specific standards. One character of the new accounting standards is a comprehensive implementation of fair value. 17 out of 38 specific standards require using fair value as a measurement tool.

3.2 The characters of 17 fair value standards

Through these 17 standards, several characters can be concluded as follows.

(1)The excessive and extensive of the standards involving fair value

Among 38 specific standards, 17 of which are required to be measured by fair value. Besides, financial reports are related to the profits and losses on the changes in fair value, which would be considered as the indirect implementation of fair value. In short, the core of the new accounting standard is to replace the historical cost accounting for fair value accounting.

(2)The criterions of fair value measurement are strict

In the new accounting standards, it is required fair value to be reliable measurement. However, according to the criterions of the reliable fair value measurement, there is non-uniform approach. (Su, 2008) Also, the criterions are different on the basis of different specific standards.

For example, in the standards of "Investment Real Estates", there should be well-established evidence to show that the fair value of an investment real estate can be obtained in a continuous and reliable way. And the criterions of the reliable measurement through the fair value pattern is *(1) an active trading market of real estate in the location of the investment real estate; and (2) The enterprise is able to obtain the market prices of the identical or similar real estates and other relevant information from the trading market of real estate, so as to be able to estimate the fair value of the investment real estate.* (Article 10, No.3, ASBE 2006)

In the standards of "Business Combinations (not under the same control)", *As for the assets other than intangible assets acquired from the acquire in a business combination, if the economic benefits brought by them are likely to flow into the enterprise and their fair values can be measured reliably, they shall be separately recognized and measured in light of their fair values.*(Article 14, No. 20, ASBE 2006) In this situation, reliable measurement through the fair value pattern could be achieved either directly from the market or using value appraisal techniques. Nevertheless, the input variable of the techniques is ambiguous. (Su, 2008)

(3) Lack of the uniform framework of the measurement of fair value

There is no uniform framework in the new accounting standards. (Su, 2008) The solutions of the practical problems involving the fair value measurement could hardly be found in the accounting standards. In the whole new accounting system, only “Recognition and Measurement of Financial Instruments”, “Enterprise Annuity Fund” and “Impairment of Assets” provide the guides of the measurement of fair value. (Su, 2008) However, the three guides of those three standards are different from each other. “Impairment of Assets” prefers the price as stipulated in the sales agreement in the fair transaction while “Recognition and Measurement of Financial Instruments” uses the active market price as preferred choice. (Su, 2008)

3.3 Difference perspectives influence the accounting practices

There are major international difference in accounting practices according to varies perspectives. (Nobes and Parker, 2008) It is obvious that China is a special case due to its complex cultural, legal and economic environment. We follow Nobes’s model to explain how the specifics of that very accounting system are framed and based on China’s environment and the possible relationships connected with the accounting choice in listed companies.

3.3.1 Culture

Obviously, accounting method is affected by its environment, including the culture of the country in which it operates. (Nobes and Parker, 2008) According to Gray (1988), it can be possible to establish the relationship between accounting values and the four significant cultural value dimensions in Hofstede’s model including individualism, power distance, uncertainty avoidance and masculinity. Accounting values were developed by Gray into four pairs: Professionalism versus Statutory Control, Uniformity versus Flexibility, Conservatism versus Optimism, and Secrecy versus Transparency (Nobes and Parker, 2008). Gray (1988) also stated that the lower a country ranks in terms of individualism and the higher it ranks in terms of uncertainty avoidance and power distance then the more likely it is to rank highly in terms of statutory control, uniformity, conservatism and secrecy. Besides, Gray (1998) thought masculinity is much lesser importance in the system of accounting values.

According to the model defined by Hofstede, the four basic dimensions of culture in China can be summarized as follows:

(1) Power Distance

According to Hofstede's survey, China, with its high Power Distance Index of 80, ranked 7th on this power distance dimension, while the USA 52nd, Australia 54th, Great Britain 57th, out of a total of 53 countries (ClearlyCultural, 2009).

(2) Collectivism – Individualism

Individualism stands for a preference for a loosely knit social framework in society wherein individuals are supposed to take care of themselves and their immediate families only. (Nobes and Parker, 2008) Compare to collectivist culture, Individualist usually more connected with democratic principles. Out of unexpected, United States is on the top of individualism scale. China, with its low 20 in individualism – represents 49th out of 66 countries (ClearlyCultural, 2009).

(3) Masculinity-Femininity

Masculinity, versus its opposite, femininity prefers a society for achievement, heroism, assertiveness and material success (Nobes and Parker, 2008). The Masculinity scale of China is above average, ranks 10th out of 66 countries. (ClearlyCultural, 2009)

(4) Uncertainty avoidance

China has low uncertainty avoidance, ranks 56th out of 66 countries. (ClearlyCultural, 2009) Low uncertainty-avoidance cultures, such as China, Singapore, Hong Kong, U.K. and Malaysia, maintain more relaxed atmosphere in which practice counts more than principles and deviance is more easily tolerated (Nobes and Parker, 2008).

Therefore, China, considering its different culture perspectives, has large power distance and low individualism (ClearlyCultural, 2009). It reflects the highly statutory control, uniformity, conservatism, and secrecy, which could influence listed companies' accounting choices. Moreover, fair value measurement requires more professional judgments and disclosure than historical cost measurement. Also, fair value measurement believed that prudence (conservatism) is a distortion of accounting measurement, violating faithful representation (Whittington, 2008). Considering the characters of fair value and historical cost measurement, we think the special culture characters in China could affect the accounting choice in listed companies.

3.3.2 Legal system

China's legal system consists of laws of seven categories: the Constitution and related laws, civil and commercial laws, administrative laws, economic laws, social laws, criminal laws, and litigation and non-litigation procedural laws. (The Constitution and Legal System, 2006) The first formal piece of legislation is traced to the establishment of the People's Republic of China in 1949. During the last three decades, since the opening-up policy and the impressive economic growth, legal system has been developed rapidly in China. Over the years, China has established "a socialist legal system with Chinese characteristics" and with the Constitution at the core (White paper, 2008)

Unlike United States and France, there is no strict precedential concept for case law or common law in China. "In China, laws are usually broadly drafted with much discretion left to implementing authorities. Some laws have amounted to little more than statements of principle. Real clarity exists only at the level of administrative rules, circulars or bylaws."(The Legal System in China) Besides, according to the research by Franklin Allena et al (2005), compared with 49 sample countries, law enforcement, creditor and shareholder protection in China are significant below average. Furthermore, for most western countries, there exists the separation of powers between legislative, judicial and executive institutions. Nevertheless, the Communist Party of China (CPC) holds the dominate power in all fields including finance, legislative, judicial and executive in China. The most direct effect that influences the listed companies' accounting choice is the accounting standards issued by the Ministry of Finance. The accounting and taxation standards are set to achieve the expectation and economic goals of government. According to the new accounting standards, the implementation of fair value is required among listed companies. However, there is a transitional period including mandatory and voluntary standards, which provided listed companies the accounting choice between two measurements in legal perspective.

3.3.3 Economic system

Economic system is a major element influences the accounting standards and accounting choice in China, which can be divided into two periods. The first period is from 1949 to 1978. As a socialist country, China had been relying on a central planning economic system to allocate the state budget to all the companies in the country (Allen et al, 2005). Nearly all the domestic companies were state-owned, and the government had dominated power to allocate the resource and distribute the investment funds. Within this period, Chinese GDP increased slowly, and kept almost unchangeable for nearly 30 years. Since the second period from1978, China began to reform economic system by adopting the market economic gradually. Under the market economic system, the ownership structure of China has been changed. The state sector accounted for only 28.5% of China's total industrial output in 1996 (Allen et al, 2005). Significant influence and rapid economic growth have been achieved during this period. Based on the data of GDP issued by the Statistics Bureau, we calculated that China's GDP grew at an average annual rate of 9.36% from 1978 to 2009.

Domestic bank loans, firm's self-fundraising, state budget and foreign direct investment (FDI) are the four most important financing sources for all firms in China (Allen et al, 2005). The state budget now only account for 10% of state-owned companies' total funding (Allen et al, 2005). Moreover, China's stock markets have been growing rapidly since the early 1990s with the creation of two stock exchanges in Shanghai and Shenzhen. Within a decade, the Shanghai Stock Exchange and Shenzhen Stock Exchange had been two of the largest stock markets in terms of market capitalization (2704778.4 USD million and 868374 USD million respectively in 2009) in the world. According to the Wind database, up to 2009, there are 953 state-owned listed companies, account for over 50% in stock markets, with the overall market value exceed 21trillion RMB.

With the trend of business globalization, listed companies are expected to choose fair value accounting to attract more international capital flows and foreign investments. Since IFRS has been accepted by more and more countries worldwide, it is much easier for listed companies to expend their international business and to be listed in the foreign stock markets through fair value measurement. Furthermore, the diverse providers of finance require more disclosure from listed companies than before. Under these situations, listed companies tend to choose fair value measurement.

However, as an emerging country, China's markets are not active and mature enough as the developed countries. The markets are still not efficient due to lacking of protection of the investors and imperfect regulation (Morck et al, 2000). Noticeable risks and problems still exist in stock market and commercial banking system, such as a high degree of speculative, overvaluation (high price-earning ratios), low cash dividend yields and nonperforming loans (Lau and Wang, 2003). Those problems and risks would threat the future economic development and affect the prospects of using the advanced accounting method (Lau and Wang, 2003). Moreover, considering the high percentage of state-owned companies in the listed companies, it is hard for those companies to strive from the traditional historical cost accounting to fair value accounting. Thus, it is possible that some listed companies would stay back from fair value accounting during the transitional period.

Tax system

As an important instrument, taxation is used by the government to control the economy. In 1992, NPC revised “The People’s Republic of China on Tax Collection and Administration Law” which represented a separation system between taxation and accounting system. Through there are still exist correlation between tax and financial reporting for most domestic enterprises, taxation and financial reporting has separated in recently years. Hence, tax base and accounting base are not the same. For example, taxable income is based on the initial entry value, which means the Gain/Loss of the change of fair value would not affect the taxable income. However, this item becomes the tax base, which under the situation like Gain/Loss of the change of fair value arises with the assets or liabilities transactions. Hence, considering the potential taxable income based on the fair value measurement, some listed companies may delay the implementation of fair value accounting when making the accounting choice.

Chapter IV Theory

With the aim of explaining the factors that influence the accounting choice in listed companies during the transition period, positive accounting theory together with institutional theory are applied to set the predictions about the accounting choice. In this chapter, first, we will create our hypotheses based on positive accounting theory and then on institutional theory. A summary will be drawn in the end of this chapter to demonstrate the complementary nature of the two theories.

4.1 Predicting accounting choice through the lens of positive accounting theory (PAT)

Historical cost accounting only accounts for the original cost with reliable and verifiable as the main characters. In contrast, fair value accounting is towards the future, improving the comparability of the accounting information for the users to do the economic decisions (Matis and Mustata, 2004). Then, what factors influence the listed companies to choose between historical cost accounting and fair value accounting? Positive accounting theory (PAT) assumes that the economic incentives affect managers when selecting accounting method (Fields et al, 2001; Zmijewski and Hagerman, 1981; Collin et al, 2009). The theory is based on the proposition that managers attempt to maximize their utility which is directly related to their compensation and hence wealth. (Zmijewski and Hagerman, 1981) Also as Zmijewski and Hagerman (1981) stated, managers will lobby for and choose the accounting measurement which decrease or defer tax payment, help secure favorable regulations, decrease political costs, decrease information production costs, and/or increase managers' cash bonuses.

Both Shanghai and Shenzhen stock exchange markets have A-share and B-share markets. The primary distinction is that A-share market is open to domestic investors and B-share market is only open to foreign investors. Foreign investors require listed companies to be more transparency and disclosure more relevant information in order to make the economic decision. Moreover, managers would prefer an accounting measurement which allows them to report selective subset of information to different groups (Zimmerman, 1977). Managers will choose the accounting method which will provide more information under the following two situations: (1) the accounting method will increase the wealth of all contracting parties, or (2) the accounting method will make the manager better off at the expense of some other contracting parties (Watts and Zimmerman, 1990). Besides, considering being limited by the shareholders through contracting and monitoring (Broberg et al. 2009), managers prefer to choose the shareholders' favorable accounting method to provide more information disclosure (Watson et al. 2002) to obtain the best interests of the shareholders. However, due to different culture and risk, information asymmetry will be involved (Adrem, 1999) and thereby increases the risk of conflicts and misunderstanding between foreign shareholders and managers. (Broberg et al. 2009) Thus, by using fair value accounting to provide more transparency and relevant information to the foreign shareholders, managers could reduce the potential conflicts. This leads us to the first hypothesis:

HPAT1. Those listed companies with B-share market will have a higher probability of selecting fair value accounting than the listed companies with A-share market.

When we emphasize on the ownership structure of the listed companies, the hypotheses can be developed as follows. One common way of defining and measuring ownership structure is to measure ownership concentration (Roberts, 1999; Prencipe, 2004). According to Adrem (1999), it frequently occur conflicts of interest and opportunistic management behavior between managers and stakeholders in those corporations with a dispersed ownership structure. On one hand, the corporations with a dispersed ownership structure consist of larger and more diverse organizations as stakeholders, implying an increasing requirements of accounting information about the transactions (Collin et al., 2009), whose needs could be achieved better through using fair value accounting. On the other hand, concentrated ownership with a single dominates owner needs less information and additional control (Collin et al., 2009) compared with dispersed ownership. Besides, the distance between the middle management and the top management is bigger in the dispersed ownership corporations rather than in the concentration ownership corporations, which will lead to an information asymmetry problem. Hence, in general, the corporations with dispersed ownership structure tend to choose fair value accounting to disclosure more relevant information than those corporations with concentrated ownership (Prencipe, 2004). Therefore, building on the ideas of ownership constructer, we hypothesize:

HPAT2. Those listed companies with dispersed ownership structure are more prefer to use fair value accounting than the listed companies with concentrated ownership.

According to Belkaoui and Karpik (1989), management has the knowledge to make a company profitable. As Company Law and Securities Law stated, financial difficulties in listed companies of China will be referred as Special Treatments when there is a continuous minus net profit over two fiscal years or when the net asset value per share is lower than the face value in the latest fiscal year. Once those listed companies in the Special Treatments has a continuous minus net profit over three fiscal years, they are required to delisting from the stock market. For those troubled companies, in order to keep their positions, mangers have incentives to increase reported earnings to avoid the intervention by the firm's board of directors (Pourciau, 1993; Weisbach, 1988; DeAngelo, 1988; Moyer, 1990; Petroni, 1992). Besides, managers within those troubled companies, are close to a debt covenant violation, have incentives to take action to increase the income of the firms to avoid or defer the costs of a breach (DeFond and Jiambalvo, 1994; Watts and Zimmerman, 1986; Sweeney, 1991; Healy and Palepu, 1990). Fair value accounting has been known as based on the current price to measure the transaction of the assets or liabilities. According to China's new accounting standards, Gain/Loss of the change of fair value will be shown in the income statement directly. Unrealized holding gains and losses are recognized in current earnings (Barth et al. 1995). Hence, there is a higher probability for managers in those troubled companies to choose fair value accounting in order to increase the income. Moreover, based on the findings of Deangelo et al. (1992), manager's accounting choice primarily reflects the firms' financial difficulties. Furthermore, managers most likely viewed their firms' problem as persistent

(Healy and Palepu, 1988; Fama and Babial, 1968). In order to get the long-term compensation instead of the short-term profits, managers tend to choose the accounting measurement which can provide more real information about the companies’ operation to the board of the directors. Thus, viewpoints discussed above support our third hypothesis:

HPAT3. The listed companies in Special Treatments with financial difficulties are more inclined to use fair value accounting.

With the development of financial market, more financial instruments including the derivative financial instruments are developed by the financial companies. Since then, the historical cost accounting has been critical by the users, especially for the derivative financial instruments, since most of them do not have the initial purchase price due to their inherent characters (Zhao, 2007). Since accounting has the function of producing information for decision makers (Collin et al., 2009), managers have the responsibility to choose the appropriate accounting method to provide the relevant information for decision makers. This is, however, not an argument of economics, but of ethics theory. (Collin et al., 2009) If managers choose the accounting measurement which will lead to a problem of investment security, it will influence the development of the firms and affect the managers' long-term profit finally. Further, the information asymmetry between managers and investors are graver in the transaction of financial instruments. Using fair value accounting can not only provide more relevant information disclosure to shareholders but also decrease the information asymmetry and consequently also the agency cost (Adrem, 1999). In consequence, we predict that, according to the industry, the listed companies tend to make different accounting choice as hypothesis 4:

HPAT4. Financial industry prefers to use fair value accounting

Finally, size is a variable that has frequently been used to explain the accounting choice of managers, especially to explain the extent to which disclose information (Belkaoui and Karpik, 1989; Hackston and Milne, 1996; Trotman and Bradley, 1981). Most of empirical researches have found a positive relationship between corporate size and the extent and transparency of disclosure information (Hussein, 1996; Jaggi and Low, 2000; Scott, 1994). Jensen and Meckling (1976) argued that the agency costs would increase with the share of external capital. And as Leftwich et al. (1981) has shown, the share of external capital tends to be high in large corporations. Managers use the accounting method which can disclosure more transparency information, to reduce the information asymmetry and consequently also the agency costs (Adrem, 1999). Besides, the big companies consist of larger and more diverse organizations with many more employees, implying a need for more abstract information about the operations through a more elaborate accounting method. (Collin et al., 2009) However, Jensen and Mecking (1976) have argued that the corporations are subject to political attack. In general, firm size is used to proxy for political costs (Wong, 1987; Zmijewski and Hagerman, 1981; Lee and Hsieh, 1985; Watts and Zimmerman, 1986), although it has been criticized by Ball and Forster (1982). In order to avoid the political cost, the managers of the big companies have incentives to choose accounting measurement which increases the transparence information (Scott, 2003; Ness and Mirza, 1991; Clarke and Gibson-Sweet, 1999; Gray et al. 1995). Hence, our hypothesis 5 can be stated as:

HPAT5. There is a positive association between size and fair value accounting

Summarizing our predictions based on positive accounting theory, we have found that the theory with the agency problem and managerial behavior, with its focus on B-share market and dispersed ownership structure, predicts that those listed companies will prefer to choose fair value accounting. Also, Similar accounting choice will be made within financial industry or within big size companies. Moreover, those listed companies in Special Treatments with financial difficulties have high probability to select fair value accounting.

Now we turn our attention towards institutional theory to obtain a different perspective to explain the accounting choice in listed companies during the transitional period.

4.2 Predicting accounting choice through the lens of institutional theory (IT)

The accounting choice based on PAT generally ignores how institutional pressures. Institutional theory is useful in explaining accounting choice in listed companies where self-interest maximizing actors cannot exert effective influence over the choice of accounting measurement because of their relative power positions in their organizations. (Carpenter and Feroz, 2001) We argue that institutional theory can complement positive accounting theory in explaining accounting choice in China's case. It will be more effective using both of them together to explain the accounting choice, which has been proved by Collin et al.'(2009) empirical research. In this section, we present the basic perspectives of IT and develop hypotheses to explain the factors that influence listed companies' accounting choice. Since the hypotheses based on PAT and IT share similar characters, it will support our opinion that PAT and IT are complementary in explaining the accounting choice in listed companies.

IT, as it has been used in studies of accounting choice (Carpenter and Feroz, 2001), is based on the organizations' operating within a social framework of norms, regulations and assumptions about what constitutes appropriate behavior (Oliver 1997; Scott 1995). Decisions are made not only on basis of economic criteria, but also according to what is acceptable and legitimate within a particular environment or organization field that generally moves toward common structures and processes due to coercive, imitative, and normative isomorphism (DiMaggio and Powell, 1983 in Collin et al., 2009). The three different mechanisms isomorphism are important to explain how decision makers are influenced by institutions.

Coercive isomorphism appears with formal and informal pressure exercised on the organization by the other organizations on which they depend and the expectations of the society in which the company works. (DiMaggio and Powell, 1983) Collin et al. (2009) argued that the coercive isomorphism is mainly a resource-dependency explanation. According to Scott (1995), coercive isomorphism stems from the organization with rulers, with mechanisms of surveillance and of the activities of penalty. In other words, power is a central variable in coercion isomorphism. (Touron, 2003)

Imitation isomorphism resulting from standard responses to uncertainty, which means the organizations model themselves on the others to make similar choices to its own (DiMaggio and Powell, 1983). In other words, the managers of companies facing a uncertainty situations are more prefer to adopt the similar decision with the successful ones in their institutional fields"(Touron, 2003; Collet et al. 2008). Thus, according to other organizations' successful decision in their institutional fields, the managers of companies will be regarded as legitimate (Granlund and Lukka, 1998). According to Touron (2003), mimetic adoption supposes the following three elements: (1) a copied and adopted model; (2) uncertainty with regard to the effects of the tools and (3) a mechanism that like the first two elements (cognitive legitimacy).

Normative isomorphism is claimed to be performed mainly through professional groups promoting their competence in society. (Collin et al., 2009) Touron (2003) argued that the professional groups lead to a normative isomorphism is based on the transmission of norms. The norms will be taken-for-granted (Berger and Luckmann, 1967). Besides, normative mechanism, gives priority to moral beliefs and internalized obligations as the basis for social meaning and social order (Scott and Christensen, 1995). Hence, Scott (1995) argued that the organizational behavior is not only based on self-interest and expedience, but also an awareness of one's role in a social situation.

Thus, we predict listed companies will tend to choose the accounting measurement considering the organizational pressures including the three isomorphism. It should be noted that these three isomorphism are applied in isolation or together in the following analytical hypotheses.

Our first hypothesis is based on the two kinds of share markets, A-share and B-share market, in the stock markets. Due to B-share market is only open to foreign investors, those listed companies consist of B-share are facing to the global market directly. Traditionally, institutional factors include external institutions such as rules, regulatory structures and agencies (Touron, 2003). However, the field has been extended to broader area including other firms like competitors in the same industry or units within the same markets (Touron, 2003). Therefore, listed companies which have B-shares are referred as members of global organization field. Nowadays, increasing listed companies in the international financial market use fair value accounting. Hence, the listed companies would more likely to take the similar or same accounting measurement with the competitors that offer similar services to customers (DiMaggio and Powell, 1983; Mangos and Lewis, 1995; Inchausti, 1997). The mimetic behavior for listed companies is derived from a need to gain competitive similarity, to create legitimacy (Collin et al., 2009). Besides, in order to avoid the risk of investment, the foreign shareholders have a security incentive to press the listed companies in B-share market to use the same accounting measurement with IFRS, be more transparency and disclosure more relevance accounting information. Under the pressure of the foreign investors, listed companies in B-share market are more likely to take the same accounting measurement with their global competitors. In sum, the mimetic behavior is caused by needs to satisfy foreign shareholders' requirements.

Moreover, listed companies, as members of the society, have the responsibilities to keep the market safe and provide the accounting information for the users. Thus, the normative influence due to moral beliefs and internalized obligations is the basis for social meaning and social order (Scott and Christensen, 1995). In sum, institutional influences from mimetic behavior and normative influence will affect the accounting choice in listed companies. Thus the prediction can be summarized as:

HIT1. Those listed companies with B-share market will have a higher probability of selecting fair value accounting than the listed companies with A-share market.

Then, we emphasize on the variable of auditing firm derive from IT. Based on Scott (1995), norms are transmitted by the process of authorization. The professionalization of companies' management activities explains the accounting choice. Indeed, a normative isomorphism stems from the pressure arising mainly through professional groups promoting their norms (Touron, 2003). Auditors and auditing firms are important in the process of institutionalizing accounting measurements (Touron, 2005). The auditors are responsible for securing users confidence in the companies' financial reports (Touron, 2003) through the auditing results whether the companies receive an unqualified opinion. Auditors influence the companies' management through their professional bodies. They will provide a distorted opinion if the companies do not provide an accurate or appropriate information of the account of the firm. Thus, they can influence and require their clients to apply their accounting measurements and relations, which means the auditors exercise normative pressure regarding companies' choice of accounting measurements (Collin et al., 2009).

In general, the Big Four auditing firms (KPMG, Ernest & Young, Deloitte and Price Waterhouse Coopers) rather than national auditing firms are more likely to influence or require their clients to adopt the advanced accounting. According to Seidler (1969), international accounting firms are the most effective vehicle for the transfer of accounting competencies. It is much easier for them to grasp the accounting measurement and standards in a global world. Besides, Big Four auditing firms require more information disclosure by companies which are audited than the national small auditing firms (Inchausti, 1977). Hence, facing the fair value accounting, those listed companies as the clients of Big Four auditing firms tend to use it.

Moreover, fair value accounting requires substantial judgments by the preparers and the auditors which may arise from litigation risk (Laux and Leuz, 2009). In this situation, auditors are likely to weigh the personal costs and risks. However, in general, Big Four auditing firms are more competence and more likely to use the advanced technologies and skills, which will decrease the litigation risk. Hence, we also believe that Big Four auditing firms could influence the listed companies to adopt fair value accounting. Thus, we hypothesize that:

HIT2. Those listed companies used Big Four auditing firms rather than national auditing firms prefer fair value accounting.

Size is another factor we argue will affect the accounting choice in listed companies. Based on institutional theory, listed companies not only are a part of the local organizational field, but also belong to a global organizational field, especially for big companies. In order to attract more foreign investments and increase the share of international market, the big companies are more likely to adopt the same or similar accounting measurement as their global competitors. Therefore, the mimetic behavior will influence the big listed companies to choose fair value accounting.

Besides, in comparison to medium-sized enterprises (SMEs), big companies are typically regarded as resource-sufficient, market power, knowledge and resources to operate viably in domestic and international markets (Fujita, 1995; Knight, 2000; Coviello and McAuley, 1999; Hollenstein, 2005). Hence, big companies own the competent employees and a large amount of professional accountants, which will reduce the risks and costs of turning from historical cost accounting to fair value accounting. What's more, big companies prefer selecting the Big Four auditing firms as their external auditing authorities. The professional groups will struggle for the right and the opportunity to define the methods of their work (Dimaggio and Powell, 1983), which also provide incentives to big companies to apply fair value accounting. Hence, the normative behavior caused by the professional pressure, affect the listed companies' accounting choice.

Furthermore, in general, big listed companies have more subsidiaries in both domestic market and overseas. Most of subsidiaries in the developed countries adopt IFRS, which mandates them to use fair value accounting and disclosure more information. And those parent companies are more likely to use the same accounting measurement in order to decrease the costs of consolidate the financial reports. Thus, based on institutional theory, the pressure stem from the mimetic, normative and, to a certain extant, coercive influence will affect the accounting choice. Therefore, we predict big listed companies prefer fair value accounting:

HIT3. There is a positive association between size and fair value accounting

With the PAT predictions in the industry, the same prediction can be made based on IT. In previous research, industry was one of the most common variables for explaining the accounting choice (Ljungdahl, 1999; Collin et al., 2009; Verrecchia, 1983). According to IT, it predicts that organizations are inclined to imitate the behavior norms of other actors in the organization field. (Touron, 2003) It is rational for an organization mimic competitors to consider acceptable and legitimate within its organizational field (Scott, 1995). Otherwise, the behavior of mimicking competitors can be part of a competitive strategy (Collin et al., 2009). Since China is a member of WTO, the financial industry is facing more fierce competitions. On one hand, many foreign financial institutions flood into China' financial market. On the other hand, China' financial companies join in the global financial market. According to Westney (2003), the firm may be considered as a member of global organization field when its financial markets, competitors, and customers become more global in scope. Obviously, financial industry is more likely to be the members of the global organization field than the non-financial industry due to mimic influence.

In addition to this mimetic influence, one must consider the normative influence relative to the factor of industry. Professions pressure is a part of the incentives that influence the accounting choice in listed companies. Moreover, in financial industry, many financial instruments, especially the financial derivative securities, do not have the initial price. And using historical cost accounting will distort the financial condition and financial assets or liabilities. In order to provide a real financial information to the users, auditors, especially for the auditors who come from the Big Four auditing firms, are more likely to press the financial companies to choose the fair value accounting. We therefore hypothesize as follows:

HIT4. Financial industry prefers to use fair value accounting

According to Company Law and Securities Law, listed companies with financial difficulties will be referred as Special Treatments (ST) when there is a continuous minus net profit over two fiscal years or when the net asset value per share is lower than the face value in the latest fiscal year. Once those listed companies in the Special Treatments has a continuous minus net profit over three fiscal years, they are required to delisting from the stock market. The financing channels and corporate credit will be destroyed when they are delisted from the stock market. Thus, the risk of delisting from the stock market will stimulate the listed companies to choose fair value accounting in order to increase the net profit and income. The coercive behavior is reinforced by the pressure of the Company Law and Securities Law on the Special Treatments of those listed companies with financial difficulties.

Moreover, the shareholders of ST-share companies require more information disclosure in order to grasp the real financial condition of the companies. Due to the companies' moral responsibility for the shareholders; they are more likely to adopt the accounting measurements which can provide more transparency information disclosure. Besides, the auditing firms may require those listed companies to disclosure more accounting information in order to decrease their auditing risks. Thus, normative approach caused by the needs from the professional group and the shareholders. In short, owing to the coercive and normative influence, the listed companies in Special Treatments with financial difficulties tend to choose fair value accounting.

HIT5. The listed companies in Special Treatments with financial difficulties are more inclined to use fair value accounting.

Finally, we consider the foreign list as a variable to explain the accounting choice of the listed companies. All the listed companies are listing on either Shanghai (SH) or Shenzhen (SZ) stock exchanges. And some companies also listed on Hong Kong stock exchange. Although as a part of China, Hong Kong used to be a colony of UK for a long time. And now, Hong Kong still uses the system which is more UK's and totally different compared to mainland of China including financial system, legal system and accounting system. Also, Hong Kong use IFRS. Due to the special characters of Hong Kong stock market, it can be treated as a foreign stock exchange while SH and SZ are considered as domestic stock exchanges. Those companies listing on Hong Kong stock exchange have more foreign shareholders than the companies only from SH or SZ, which require more transparent and accounting information disclosure. It has been found in Sweden and some other countries that corporations listed on foreign exchanges as well as the domestic stock exchange disclosed more voluntary information than corporations only listed on the domestic stock exchange (Cooke, 1989; Broberg et. al, 2009), which also fit for China's case. Besides, Hong Kong uses IFRS, one core of which is fair value. As for coercive influence, those companies listed on Hong Kong exchange are required to use IFRS in their business in Hong Kong. Considering the application of IFRS for those companies, it is much easier and cost-saving if the companies choose fair value accounting. Therefore, we can conclude our hypothesis 6 as follows:

HIT6. The companies listed in Hong Kong stock exchange as well as local stock exchange use more fair value accounting compared with the companies only listed in Shanghai or Shenzhen stock market.

4.3 Summarizing the prediction of the listed companies' accounting choice

Through two different theory approach, positive accounting theory and institutional theory, we stressed several predictions, some of which have similarity. The different hypotheses are summarized in Table 1.

We have notice that, in general, listed companies will prefer to choose historical cost accounting. Exceptions to this general tendency will exist in financial industry or big companies based on both PAT and IT. Also, as PAT and IT stressed, listed companies in B-share stock market, in Special Treatments or use Big Four auditing firms have a high probability to choose fair value accounting. Besides the similarity shared with PAT and IT, there are also complementary theories of listed companies' accounting choice. In one hand, PAT, focusing on the ownership structure, added the prediction that dispersed ownership will tend to choose fair value accounting. In the other hand, IT, stressing those listed companies on foreign exchange are more likely to use fair value accounting. Therefore, PAT and IT are both essential theory approach in explaining the factors that influence the accounting choice of listed companies between historical accounting and fair value accounting in China.

Table 1 Predictions derived from PAT and IT

Factor	PAT prediction	IT prediction	Prediction
1. Share market (B-share)	Fair value	Fair value	Identical
2. Ownership (Dispersed ownership)	Fair value	No prediction	Complementary
3. Special Treatments	Fair value	Fair value	Identical
4.Auditing firm (Use Big Four)	No prediction	Fair value	Complementary
5. Industry (Financial industry)	Fair value	Fair value	Identical
6. Size (Big size)	Fair value	Fair value	Identical
7. Foreign list	No prediction	Fair value	Complementary

Chapter V Empirical Method

Reiterating the aim of the paper, it is to explain the factors that influence the accounting choice of listed companies between historical cost accounting and fair value accounting during the transition period. A number of hypotheses derived from positive accounting theory and institutional theory are predicted to explain the accounting choice of listed companies. Since our object is to exam the influence of different factors, we collect a sample of listed companies in China. Also, we chose 2007 as the transition period since it was the first year of implementation of fair value in China. The Wind database provides us with almost all the data of listed companies. Also, there were some missing data such as the turnover. Thus, we also collected the data from the 2007 financial reports of some companies to fix the missing data. In total there were 1841 listed companies in China. Overall, the data sources contain the information of all the listed companies in China we need.

5.1 Variables

Dependent Variable

The dependent variable, accounting choice made by listed companies in China, is divided into two areas: historical cost accounting coded 0 and fair value accounting coded 1. During the transition period, listed companies could choose from these two different accounting measurements, which raised the accounting choice problem. In total of 1841 listed companies in China, 437 listed companies chose fair value accounting while 1404 companies stick to historical cost accounting. In order to measure the extent and explore the factors that influence the accounting choice, the following independent variables were set to measure the hypotheses.

Independent Variables

Some variables we applied in the thesis are based on the former empirical researches while the others are developed due to the specific conditions and characters of China's market for listed companies.

The variable *Share market* was given by the Wind database showed the Statistic data from stock markets. According to China's stock markets, there are B-share market and A-share market. Our sample of listed companies contains both share markets. Thus, we set those listed companies in B-share market as value 1 and those in A-share market as value 0.

Then we focus on the variable of *Ownership,* which have been used by numbers of authors (Missonier-Piera, 2004; Bradshaw et al., 2004; Chugh and Fargher, 2008; Collin et al., 2009; Broberg et al., 2009). However, in order to fit China's special conditions, we do not follow the former foreign empirical researches due to cultural difference and different general knowledge. We divide the listed companies into two groups. One group, the concentrated ownership, one single party dominates at least 51% of the company (Yongxiang Sun and Zuhui Huang, 1999; Wuxiang Zhu, 2002; Shaoyan Sun, 2004), which means there exists an absolute controlling shareholder, is given the value of 1. The other group is the dispersed ownership which represents there are lots of small shareholders and none of them own over 51% of the company. This group is given the value of 0.

Considering the *Financial difficulties* as a variable, we evaluate the listed company within financial difficulties depend on whether the company is in Special Treatments. According to Company Law and Securities Law, listed companies will be considered as Special Treatments if there exist a continuous minus net profit for two fiscal years or the net asset value of per share is lower than the face value in the latest fiscal year. Listed companies in Special Treatments are treated as having financial difficulties and coded as value1. Otherwise, those listed companies not in the ST will be coded as value 0.

The independent variable *Industry* (Collin et al., 2009; Christie, and Zimmerman, 1994; Thornton, 1986; Cullinan and Knoblett, 1994; Broberg et al., 2009) follows the categories given by the Wind database. The categories consist of three key sectors, the primary sector; the secondary sector and the tertiary sector, which including financial, manufacturing, construction, sales, information techniques, real estate, mining and farming and so on. In order to fit the hypothesis better, we divide industry into six parts: (a) financial; (b) sales; (c) manufacture; (d) construction and real estate; (e) information techniques and (f) the others.

The variable *Size* was evaluated based on the turnover of the listed companies (Missonier-Piera, 2004; Trombley, 1989; Collin et al. 2009; Christie and Zimmerman, 1994; Broberg et at. 2009). Alternative measures of size could be number of employees (Belkauoi and Karpik, 1989; Prencipe, 2004; Roberts, 1992; Adams et al., 1998) and total assets (Jaggi and Low, 2000; Cormier et al., 2005; Watson et al., 2002, Zarzeski, 1996). However, it is difficult to divide the listed companies based on number of employees since there exist huge difference between varies industry categories. Also, those companies with less number of employees may have higher profitability than those companies with more number of employees. Additionally, there are no existing categories to evaluate the size according to net value of assets of listed companies and it is not suited to use the categories from the former foreign empirical researches due to the economical environment difference. Moreover, some data of the total asset of listed companies were missing and could not be fixed even from their homepages and financial reports. Thus, we choose turnover to evaluate the size of the listed companies. We believe that it would be better if we use the exact turnover of each listed companies to test the hypothesis rather than set the value for different sizes.

The variable *Auditing firm* was observed through the auditing report, which had the signature of auditing firms (Collin et al., 2009). According to the different kind of audit firms listed companies chose, we divide those companies into two groups. Since there are only 120 listed companies who use the Big Four as their auditing firms, only account for 6.5% among all listed companies, we collect the Big Four together rather than divide them into four small groups. Also, considering there are amounts of national auditing firms and no leading one in

China, we conclude the other auditing firms exclude the Big Four as another group. Therefore, in one hand, those companies choose the Big Four auditing firms including KPMG, Ernest & young, Deloitte and Price Waterhouse Coopers were assigned as value 1. In the other hand, those listed companies use the other audit firms rather than Big Four were assigned as value 0.

The variable ***Foreign list*** was observed through the different listed stock exchanges (Chugh and Fargher, 2008; Cullinan, 1999; Cooke, 1989; Broberg et. al, 2009). All the listed companies are on either Shanghai stock exchange or Shenzhen stock exchange. However, some of the companies also listed on Hong Kong stock exchange, which can be considered as a foreign list. In view of the three stock exchanges in China, Hong Kong, Shanghai and Shenzhen, we divide the listed companies simply based on which stock exchange they listed. Due to there are only 7 listed companies both listed in Hong Kong and Shenzhen stock markets, it's not suited to divide the listed companies into Hong Kong plus Shenzhen and Hong Kong plus Shanghai. Thus, we divide all the listed companies into three groups. First group is those companies listed on Hong Kong stock market as well as one of the domestic stock exchanges. The second group is the companies only listed on Shanghai while the companies only listed on Shenzhen stock exchange is in group three.

5.2 Sample

A total of 1841 listed companies were identified in 2007 according to the Wind Database. Some exceptions and special situations will be stated in this section.

First, when we consider the ownership, we choose the single biggest shareholder in each listed company and collect the percentages of the ownership the shareholder owned. Once the biggest single shareholders owned over 51% of the companies, the company was regarded as concentrated. In this situation, we ignore the second biggest shareholders even they may also have a key power to influence the listed companies. Second, because there are not much financial listed companies, in order to get a fair analysis, we also divide the non-financial industry in to five parties including sales; manufacture; construction and real estate; information techniques and the others. Different categories may shows varies results such as the listed companies in information techniques field are more likely to choose fair value accounting compared with the companies in manufactory field. Last but not least, since there was different turnover for different listed companies, we use the exact amount of turnover rather than divide them into categories when we test the hypothesis.

A logistic regression will be used in the analysis part to present the statistic results of the sample as our analytical technique through SPSS soft ware. We apply a logit model as estimated via a maximum likelihood technique (Collin et al, 2009) and create an S-shape curve with asymptotes at 1 and 0 (Collin et al, 2009; Kennedy, 1984; Afifi and Clark, 1990)

In Table2, the descriptive statistics of the variables we set is shown.

Table 2 Descriptive statistics of the variables

Variable	Number of listed companies
Dependent variables	1841
1. Historical cost accounting (0)	1404(76.3%)
Fair value accounting (1)	437(23.7%)
Independent variables	
1. Share market	1841
B-share market (1)	108 (5.9%)
A-share market (0)	1733(94.1%)
2. Ownership	1841
Concentrated (1)	350 (19%)
(Biggest single shareholder≥ 51%)	
Dispersed (0)	1491(81%)
(Biggest single shareholder＜51%)	
3. Financial difficulties	1841
Special Treatments (1)	181(9.8%)
Non-ST (0)	1660(90.2%)
4. Industry	1841
Financial	33(1.8%)
Sales	101(5.5%)
Manufacture	1068(58%)
construction and real estate	146(7.9%)
Information techniques	138(7.5%)
The others	355(19.3%)
5. Size (turnover)	1841
Mean	5451Million RMB
S.D.	37956Million RMB
6. Audit firm	1841
The Big Four (1)	120 (6.5%)
KPMG, Ernest & young, Deloitte and Price Waterhouse Coopers	
Non-Big Four (0)	1721(93.5%)
7. Foreign list	1841
Hong Kong	51(2.8%)
Only on Shanghai	835(45.4%)
Only on Shenzhen	955(51.9%)

Chapter VI Empirical Analysis

In this section, we will analyze our predictions based on empirical test to explain the factors that affect the accounting choice in listed companies during the transition period. In Table 2, the static results are shown.

The dependent variable *Accounting choice* presents that 76.3% of listed companies chose historical cost accounting as their accounting measurement while 23.7% used fair value accounting as their accounting measurement. Based on the descriptive statistics of the dependent variable, we conclude that historical cost accounting was the main accounting measurement listed companies chose during the transition period in China.

Also, the statistic results of the independent variables, first, *Share market* shows that those listed companies have B-share only took up 5.9%. Second, the dispersed *Ownership* account for 81% in our sample, which represents there were lots of small shareholders and none of them own over 51% controlling ownership of the company. Third, the variable, *Financial difficulties*, indicates only 9.8% of listed companies were in the Special Treatments, which can be considered as being in financial difficulties. Forth, *Industry*, it is of note that the financial industry only occupied 1.8% in the sample. In contrast, over half of the listed companies were engaged in manufacture. Fifth, considering the variable of *auditing firm*, a majority of listed companies in the sample (93.5%) employed the national auditing firms rather than hired Big Four. Sixth, the *foreign list* variable illustrates that only 2.8% of listed companies in the sample listed in Hong Kong stock market as well as one of the two domestic stock markets, Shanghai and Shenzhen. Last but not least, the statistic results show that the mean of independent variable *Size* (turnover) was quite high (5451Million RMB). However, the large standard deviation (37956Million RMB) indicates that listed companies had much more variable turnovers. The high kurtosis (669.732) also proves that the turnover of listed companies in the sample was more of the variance was the result of infrequent extreme deviations, as opposed to frequent modestly sized deviations. Since the turnover variable has un-normal distribution which is tested by the K-S test, the standard procedure in statistical tests is to use the logarithmic value of turnover.

Table 3 Correlation matrix

Correlation Matrix

	2	3	4	5	6	7a	7b	8a	8b	8c	8d	8e
1. Accounting choice	0.045*	0.01	-0.026	.198**	.153**	.139**	.112**	.204**	0	-.120**	-0.003	0.021
2.Share market		-0.038	0.034	.080**	.140**	-.042*	0.023	-0.034	0.001	0.011	0.038	-0.036
3. Ownership			0.090**	-.189**	-.114**	-.087**	-0.012	0.013	0.032	0.02	-0.027	.064**
4.Special treatments				-.226**	-.064**	-0.011	0.036	-.045*	-0.015	.041*	-0.029	0.024
5. Turnover					.318**	.230**	.211**	.134**	.112**	-0.013	-0.001	-.157**
6. Auditing firm						.412**	-0.006	.279**	-0.035	-.105**	0.028	-.050*
7a. Foreign list Hong Kong							-.154**	.177**	-.041*	-.071**	-0.025	-0.023
7b. Foreign list Shanghai								0.017	.054*	-.096**	0.035	-.052*
8a. Industry: Financial									-0.033	-.159**	-.040*	-.038*
8b. Industry: Sales										-.283**	-.071**	-.069**
8c. Industry: Manufacture											-.345**	-.335**
8d. Industry: Construction												-.084**
8e. Industry: Information												

*p<0.05

**p<0.01

Based on the K-S test, the turnover variable is no-normal distribution. Thus, the Spearman correlation is presented in the correlation-matrix of the variables in table 3. For the *foreign list* variable, three dummy variables were created; the *foreign list Shenzhen* (7c) variable was excluded and used as reference group. At the same time, for the *industry* factor, six dummy variables were created; the *others industry* (8f) variable was excluded and used as reference group. The results of the correlation-matrix indicate that the accounting choice of fair value measurement is positively correlated with share market, turnover, auditing firm, foreign list Hong Kong, foreign list Shanghai and financial industry, the same as our prediction. The result also indicated that the use of fair value accounting is negatively correlated with the manufacture industry. Of note, the ownership, Special Treatment, sales industry, construction and real estate industry and information technique industry had no significant correlation with the choice of fair value accounting measurement in the correlation-matrix. Moreover, Table 4 represents the explanatory variables, which can be summarized as follows:

Table 4 Explanatory variables

Variables	Proxies	Predicted signs	Actual signs	Outcome
1.Share market	B-share coded 1 and A-share coded o	+	+	significant
2.Ownership	Percentage of the single biggest shareholder is over 51% coded 1 and 0 otherwise	−	+	no significant correlation
3.Special Treatments	Special Treatments coded 1 and 0 otherwise	+	−	no significant correlation
4.Industry	Six dummy variables were created; others industry as the reference group	.	.	.
5.Size	Turnover	+	+	significant
6.Auditing firm	Big Four coded 1 and 0 otherwise	+	+	significant
7.Foreign list	Three dummy variables were created; Shenzhen as the reference group	.	.	.

Table 5 Regression results

	Variables in the Equation			
	Full model		Model with the variables Industry and foreign list excluded	
	Probability of fair value	S.E.	Probability of fair value	S.E.
2. Share market	0.396†	0.228	0.223	0.226
3. Ownership	0.394*	0.157	0.427**	0.153
4. Special Treatments	0.171	0.207	0.17	0.205
5. TurnoverLog	0.643***	0.103	0.741***	0.095
6. Auditing firm	0.128*	0.21	0.459*	0.19
7a. Foreign list Hong Kong	0.751*	0.367		
7b. Foreign list Shanghai	0.441***	0.122		
8a. Industry: Financial	2.361***	0.57		
8b. Industry: Sales	-0.462	0.272		
8c. Industry: Manufacture	-.514***	0.147		
8d. Industry: Construction	-0.294	0.236		
8e. Industry: Information	0.169	0.237		
Constant	-7.34***	0.959	-8.309***	0.903
Model Chi-square	178.733		105.908	
Percentcorrect predicted	78.8		77.6	
Nagelkerke R2	0.139		0.084	

† $p<0.1$ *$p<0.05$ **$p<0.01$ ***$p<0.001$

Table 5 shows the logistic regression equation where the hypotheses are tested.

Comparing with the correctly classifies 76.3% of the cases which is presented in the classification table of the beginning block by SPSS, the full model in Table 5 is correctly classifies 78.8%. Although only 2.5% improvement in the correct predicted, it is satisfactory due to the improvement is from a very high starting level (76.3%). Besides, many other researchers, such as Collin et al. (2009) and Neu and Simmons (1996) also reported an almost equally low level of improvement (2.1% and 4% respectively).

R-squared ranges from 0 to 1 which is the square of the correlation between the model's predicted value and the actual value[1]. "The greater the magnitude of the correlation between the predicted values and the actual values, the greater the R-squared, regardless of whether the correlation is positive or negative"[2]. The Nagelkerke R-squared, which is 0.139, is also another explanatory power of the moderate level. Comparing with the similar studies, such as Collin et al. (2009) reported a Nagelkerke R-squared to be 0.14; our model appears therefore to be much weaker.

Also, the model could suffer from the problem of multi-collinearity. The correlations between the independent variables show the presence of a collinearity problem. Base on the correlation matrix, auditing firm and turnover are significantly correlated with many of the other variables. However, through the test with one independent variable exclude did not change the Cox &Snell R-squared (0.093) and Nagelkerke R-squared (0.139), and did not change the level of significance on the included variables. Thus, multi-collinearity could not cause a problem for the model. In order to clarify the regression results, we excluded the dummy variables for both foreign list and industry in this regression model.

As shown in Table5, ownership and turnover are significant and positively correlated in both models. Of note, share market is significant in the full model, and positively correlated as expected. However, there is no significant correlation in the second model. Besides, the variable auditing firm becomes significant if both the dummy variables for foreign list and industry excluded. The test of the dummy variables for foreign list and industry show that there are significant differences between the different stock exchanges and industries respectively, as expected. As shown in table 6, accounting choice varies considerably among different industries. Table 7 represents the different accounting choice among varies stock exchange.

Table 6 Accounting choice- fair value vs historical cost, by industry

[1] http://www.ats.ucla.edu/stat/mult_pkg/faq/general/Psuedo_RSquareds.htm
[2] http://www.ats.ucla.edu/stat/mult_pkg/faq/general/Psuedo_RSquareds.htm

	Industry					
	Finance	Sales	Manufacture	Construction	Information techniques	Others
Historical cost	12.12%	76.24%	80.62%	76.71%	73.19%	70.14%
Fair value	87.88%	23.76%	19.38%	23.29%	26.81%	29.86%

Table 7 Accounting choice- fair value vs historical cost, by foreign list

	Foreign list		
	Hong Kong	Shanghai	Shenzhen
Historical cost	41.18%	71.02%	82.72%
Fair value	58.82%	28.98%	17.28%

Chapter VII Conclusion

7.1 Discussion and conclusion of findings

Based on the outcome of empirical test, the hypothesis of share market (HPAT1, HIT1) was correctly predicted by both theories to be fair value accounting (ß=0.396, sign.=0.082), which stated that those listed companies with B-share market will have a higher probability of selecting fair value accounting compared with the listed companies with A-share market. The PAT prediction is based on the conflicts between shareholders and managers. The managers of listed companies prefer to choose the foreign shareholders' favorable accounting method due to managers are limited by the shareholders through contracting and monitoring (Broberg et al., 2009). The IT explanation is similar to the business-as-usual explanation of PAT, since the mimetic behavior with the competitors is caused by a need to satisfy foreign shareholder' requirements. But IT adds a normative explanation that listed companies have the responsibilities to keep the market safe and provide the accounting information for the users.

Considering the hypothesis of ownership (HPAT2), which is exclusively predicted by PAT, presents that those listed companies with dispersed rather than concentrated ownership structure prefer to use fair value accounting. The outcome of empirical test (ß=0.394, sign.=0.012) showed the correctly prediction of PAT. The PAT explanation is based on the conflicts of interest and opportunistic management behavior between managers and stakeholders. The corporations with a dispersed ownership structure consist of larger and more diverse stakeholders, implying increasing requirements of accounting information about the transactions (Collin et al., 2009) than the corporations with a concentrated ownership structure.

Turning to the hypothesis of Special Treatment (HPAT3, HIT5), we predicted that the listed companies in Special Treatments with financial difficulties were more inclined to use fair value accounting. Based on the outcome of empirical test (ß=-0.171, sign.=0.408), both the

PAT and IT made a failure prediction in this hypothesis. The PAT prediction is based on the conflict between agent and principal. And IT prediction tends to focus on the coercive and normative pressure from the institutions. However, both theories ignored the Chinese special conditions. According to Company Law and Securities Law require that once those listed companies in the Special Treatments has a continuous minus net profit over three fiscal years, they are required to delisting from the stock market. Nevertheless, there are only a few ST companies are prohibited to quote on the stock market in practice. The ST companies will take lots of actions to avoid prohibiting to be quoted on the stock market. Adopting the fair value accounting is one of the main methods for the ST companies to increase the income. But using the advanced accounting method only can help the ST companies to achieve the short-term goal. In general, debt rescheduling is the first and main choice for the ST companies to avoid delisting from the stock market. Back-door listing has become one of the most convenient approaches for the companies to achieve indirectly quote on the stock market (Ye, 2009). Thus, ST companies usually through selling out all of their assets to be the "single shell" listed companies, and then attract the strong shareholders to pour into the high quality assets to achieve the goal of debt rescheduling. Until now, lots of ST companies have achieved a profit instead of suffering a loss fundamentally by using debt rescheduling, such as ST Ji Zhi, ST Ke Long and ST Hui Yuan[3]. Thus, the conclusion, which is similar to the analyses of the ownership hypothesis, is that PAT and IT, is not failed in their reasoning. Hence, in order to make a better prediction, both of the two theories require more contextual information (Collin et al. 2009).

The hypothesis of industry (HPAT4, HIT4), stating that financial industry prefers to use fair value accounting. This hypothesis was correctly predicted by both PAT and IT (ß=2.361, sign.=0.000). The PAT explanation was based on the coincidence of interest between investors and the managers. And IT added the mimic influences that the listed companies tend to choose the same accounting method with the competitors. Additionally, IT did add the normative influence that the professionals, especially for the Big Four auditors are more likely to press the financial companies to choose the fair value accounting. Consequently, we found

[3] http://cfi.cn/p20100125000416.html

that institutional influence is a very important complementary for the agency choice explanation, since they produced the same significant prediction (Collin et al., 2009). Interestingly enough, based on the outcome of empirical test, there is an significant negative relationship between the manufacture industry and the fair value accounting (ß=-0.120, sign.=0.000). Moreover, there are significant differences between varies industries.

The hypothesis of size (turnover) (HPAT5, HIT3), presenting that there is a positive association between size and fair value option. Both PAT and IT have correctly predicted this hypothesis (ß=0.643, sign.=0.000). PAT predicted it from the demand of avoiding the political cost and reducing the information asymmetry and consequently the agency costs (Scott, 2003; Ness and Mirza, 1991; Clarke and Gibson-Sweet, 1999; Gray et al. 1995). IT predicted it from the mimetic behavior with the competitors and the normative behavior caused by the professional pressure, which would affect the listed companies to make the accounting choice. Watts and Zimmerman (1990) claimed that PAT was the only theory to make predictions in accounting choice about the firm size. However, Collin et al.(2009) showed an evidence competing predictions in accounting choice about firm size by using both the PAT and IT. Consequently, we found that the firm size hypothesis was correctly predicted by both theories to be fair value accounting in China. Besides, we thought we can not separate the agency choice explanation from the institutional influence. Thus, based on the outcome of empirical test, we believe that using both PAT and IT can make a better prediction about the hypothesis of size of listed companies in China.

The hypothesis of Big Four auditing firm (HIT2), which is exclusively predicted by IT, preferring fair value accounting turned out to be significant (ß=0.128, sign.=0.016). IT prediction mainly based on the normative behavior derived from professional groups. Of note, Collin et al. (2009) raised a question: is it the auditing firms that influence the corporation, or is it the corporation that chooses an auditing firm that tends to choose the accounting method that the corporation wants to select? Facing this question, it is difficult to answer only based on the outcome of our test due to only 6.5% of listed companies employed the big four as their external audit firms.

Last but not least, the hypothesis of foreign list (HIT6), which predicted those listed companies in Hong Kong stock exchange as well as one of the local stock exchanges use more fair value accounting compared with the companies only listed in Shanghai or Shenzhen. Based on empirical test, the outcome is magnificent (ß=0.751, sign.=0.041), which means that foreign list is an essential factor to explain the accounting choice of listed companies considering there are only 2.8% listed companies both listed in Hong Kong stock exchange and one of the local stock markets.

Summarizing the overall results of our empirical test (Table 8), we find a same or similar conclusion with Collin et al. (2009) and Mezias (1990) through simple arithmetic that IT has been more successful than PAT in predicting accounting choice. Based on table 8, comparing with the PAT with 4 out of 5 variables were significant, 5 out of 6 variables belonging to IT were significant. Similar results were reached by Collin et al. (2009), explaining the choice of accounting standards in municipal corporations, where 5 out of 6 variable are significant in IT prediction, but only 3 out of 5 variables are significant in PAT prediction. Mezias (1990) also got a similar result in explaining financial reporting among listed US-corporations. Thus, we also refuted Watts and Zimmerman's (1990) claim of PAT being the only viable accounting theory, like Meziaa (1990) and Collin et al. (2009) did. Besides, from the outcome of our test, we find the same results with Collin et al. (2009) that using both PAT and IT are more successful in predicting accounting choice. Especially for the prediction about the firm size, comparing with Collin et al. (2009), PAT and IT produced the same significant prediction in China. They are complementary rather than competition. Hence, using both PAT and IT to predict accounting choice not only appropriate for Sweden, but also suitable for China.

Table8. Outcome of the empirical test

Factor	PAT prediction	IT prediction	Prediction
1. Share market	Fair value*	Fair value*	Identical
2. Ownership	Fair value*	No prediction	Complementary
3. Special Treatments	Fair value	Fair value	Identical

4. Industry	Fair value**	Fair value**	Identical
5. Size	Fair value**	Fair value**	Identical
6. Auditing firm	No prediction	Fair value**	Complementary
7. Foreign list	No prediction	Fair value**	Complementary
Supported predictions	4	5	

* support.

**strong support

7.2 Criticism and future research

The major criticism against this dissertation is that the limitation of the predictions we set to explain the accounting choice made by listed companies during the transitional period in China. Although most factors have been tested that can be contributed to the explanation of the accounting choice, according to the empirical data, 78.8% of the percent correct predicted, which presents there are still some missing factors that could be magnificent to explain the accounting choice of listed companies.

Above all, one of the missing factors can be the state-owned listed companies (Tagesson et al. 2009), which means the main assets of the company is from Enterprises' State-owned Assets. The goal of state-owned operations is to maintain and add value of the asset, which means they are more conservative. Also the state-owned operations are used to adjust the capital economy of China, which shown by the controlled power of state or local governments rather than the managers of the companies. Due to historical reasons, there exist complicated categories among state-owned companies and some state-owned companies are recessive and hardly can be found and evaluated. Even the government speed up the privatization process of state-owned companies, state-owned companies still occupy a huge amount and leading the financial development of China. All the special characters of state-owned companies are supposed to influence the accounting choice of listed companies. One suggestion for future research is to explore the accounting choice of state-owned listed companies in China. Since the state-owned companies involved in different fields sharing varies characters and amounts of data needed to collected, it is of interest to focus on one perspective and dig deep.

Also, as mentioned before, foreign listing is an essential factor to explain the accounting choice of listed companies considering there are only 51 out of 1841 listed companies listed in both Hong Kong stock exchange and one of the local stock exchanges, which means the internationalization has great effect on China’s listed companies. However, we did not explore more in this factor and some suggested factors and be used in future research. First, *subsidiary companies* (Tagesson et al, 2005) can be one of the factors since being a member of WTO; China plays a more and more essential actor in the international market. There are more and more Chinese companies develop their subsidiary companies around the world and explore their business by mergers and acquisitions. For example, Lenovo, as China's largest personal computer maker, bought IBM's PC division in 2005 to become the world's third largest PC giant. And now the Subsidiary companies of Lenovo are all around the world. For those companies like Lenovo, which have lots of subsidiary companies internationally, would prefer to choose the fair value accounting since it has been accepted around the world and facilitate consolidation of its financial statements and other comparative figures between different companies within the group (Sharpe, 1988; Joshi, 1998; Nobes and Parker 2002; Tagesson et al, 2005). Also, the accounting choice of those companies could be effect by the stakeholders including suppliers, customers, shareholders and competitors. Fair value accounting will satisfy the needs from stakeholders better and saving costs such as decrease the transaction costs of an international agreement. Second, *percentage share of sales abroad* (Tagesson et al, 2005) can also show the internationalization of the companies. It shares similarity with subsidiary but in a different way. From the reasoning above it is interesting to develop *subsidiary companies* and *percentage share of sales abroad* into the hypotheses.

The above factors can be evaluated through data collecting and surveys. Moreover, there are some factors that also influence the accounting choice of listed companies in China during the transitional period, however, which are difficult to evaluate. First, resistance of listed companies to change: listed companies have used historical cost accounting for years, so they prefer to keep on the previous measurement due to the change of measurement is a deep break in practice (Demaria and Dufour, 2007). Second, fair value accounting requires more professional judgments from the accountants, which is hard to achieved during the transitional period since the historical cost measurement have been used for years and it is hard to apply for accountants. Also, lacking of professional accountants and accounting profession group make it even harder when the listed companies choose the fair value accounting. Third, the criterions of fair value measurement are strict. For example, in the standards of “Investment Real Estates”, there should be well-established evidence to show that the fair value of an investment real estate can be obtained in a continuous and reliable way. For those listed companies who could not fit every criterions of the fair value measurement, the only way is to stick the historical cost measurement. Forth, the local market is not mature and transparency enough compared with international market. The reason of the application of fair value in international market is because of the market is mature and transparency to create a soundings for fair value measurement. China’s market has not been opened to the world until 1980s, which lead to lots of problems like lacking of monitoring system, professional accountants and transparency market to provide the market price. However, the global trend is business internationalization and accounting harmonization. Doubtless, fair value is the right path for China and all the listed companies to extend their business. The accounting choice is still exist before the transitional is finish and the special conditions and characters of China make the research more complex and interesting to explore.

Appendix

1. All the Articles of 17 specific standards involving fair value

No. 20 Business combinations (not under the same control)

Article 14 The" fair value of the identifiable net assets of the acquiree" refers to the balance of the fair value of the identifiable assets acquired from the acquiree in a business combination minus the fair value of the liabilities and contingent liabilities. The identifiable assets, liabilities and contingent liabilities which meet the following conditions shall be recognized separately:

(1) As for the assets other than intangible assets acquired from the acquiree in a business combination (not limited to the assets which have been recognized by the acquiree), if the economic benefits brought by them are likely to flow into the enterprise and their fair values can be measured reliably, they shall be separately recognized and measured in light of their fair values.

As for any intangible asset acquired in a combination, if its fair value can be measured reliably, it shall be separately recognized as an intangible asset and shall measured in light of its fair value.

(2) As for the liabilities other than contingent liabilities acquired from the acquiree, if the performance of the relevant obligations is likely to result in any out-flow of economic benefits from the enterprise, and their fair values can be measured reliably, they shall be separately recognized and measured in light of their fair values.

(3) As for the contingent liabilities of the acquiree obtained in a combination, if their fair values can be measured reliably, they shall separately recognized as liabilities and shall be measured in light of their fair values.

After a contingent liability is measured initially, it shall be subject to a subsequent measurement according to the higher one of the following amounts:

(a) the amount which shall be recognized according to the Accounting Standards for Enterprises No. 13 - Contingent Events.

(b) the balance of the initially recognized amount minus the accumulative amortization amount which is recognized according to the principle of the Accounting Standards for Enterprises No. 14 - Revenue.

No.22 Recognition and Measurement of Financial Instruments

Article 30 The financial assets and financial liabilities initially recognized by an enterprise shall be measured at their fair values. For the financial assets and liabilities measured at their fair values and of which the variation is recorded into the profits and losses of the current period, the transaction expenses thereof shall be directly recorded into the profits and losses of the current period; for other categories of financial assets and financial liabilities, the transaction expenses thereof shall be included into the initially recognized amount.

Article 32 An enterprise shall make subsequent measurement on its financial assets according to their fair values, and may not deduct the transaction expenses that may occur when it disposes of the said financial asset in the future. However, those under the following circumstances shall be excluded:
(1) The investments held until their maturity, loans and accounts receivable shall be measured on the basis of the post-amortization costs by adopting the actual interest rate method;
(2) The equity instrument investments for which there is no quotation in the active market and whose fair value cannot be measured reliably, and the derivative financial assets which are connected with the said equity instrument and must be settled by delivering the said equity instrument shall be measured on the basis of their costs.

No.10 Enterprise Annuity Fund

Article 6 During the operation of the enterprise annuity fund, the initial
acquisition values and subsequent values of the national debt gained under the State investment scope, the financial debentures and enterprise obligations with the credit rating at the investment grade or above, convertible obligations, investment insurance products, securities investment funds, stocks and other financial products with good liquidity shall be measured as the fair value:
(1) The transaction price paid on the transaction date shall be measured as the fair value when an initially investment obtained. The transaction fee shall be directly recorded as profit or loss for the current period; and
(2) When estimating the value of an investment on the estimate day, the original carrying value of the investment shall be adjusted according to its fair value, and the difference between its fair value and its original carrying value shall be recorded as profit or loss for the current period.
The determination of the fair value of an investment shall be subject to the Accounting Standard for Business Enterprises No. 22 - Recognition and Measurement of Financial Instruments.

No.5 Biological asset

Article 22 Where any well-established evidence indicates that the fair value of a biological asset can be obtained in a reliable and continuous way, the biological asset shall be measured at the fair value. If a biological asset is made a measurement at the fair value, it shall meet the conditions as follows simultaneously:
(1) There is an active biological asset trading market

(2) The identical or similar market prices of biological assets and other relevant information can be obtained from the trading market, so as to make a reasonable estimate on the fair value of the biological asset.

No.3 Investment real estate

Article 10 Where any well-established evidence shows that the fair value of an investment real estate can be obtained in a continuous and reliable way, a follow-up measurement may be made to the investment real estate through the fair value pattern. To make a measurement through the fair value pattern, the following conditions shall be met simultaneously:

(1) There is an active trading market of real estate in the location of the investment real estate; and

(2) The enterprise is able to obtain the market prices of the identical or similar real estates and other relevant information from the trading market of real estate, so as to be able to estimate the fair value of the investment real estate.

Article 11 For the investment real estate measured through the fair value pattern, where there is no accrual depreciation or amortization made for it, its book value shall be adjusted on the basis of its fair value on the date of the balance sheet, and the difference between the fair value and its original book value shall be included in the current profits and losses.

No.14 Revenue

Article 5 An enterprise shall ascertain the revenue incurred by selling goods in accordance with the received or receivable price stipulated in the contract or agreement signed between the enterprise and the buyer, unless the received or receivable amount as stipulated in the contract or agreement is unfair. If the collection of the price as stipulated in the contract or agreement is delayed and if it has the financing nature, the revenue incurred by selling goods shall be ascertained in accordance with the fair value of the receivable price as stipulated in the contract or agreement. The difference between the price stipulated in the contract or agreement and its fair value shall be amortized within the period of the contract or agreement employing the real interest method and shall be included in the current profits and losses.

No. 7 Exchange of Nonmonetary Assets

Article 3 Where a non-monetary assets transaction satisfies the following conditions at the same time, the fair value of the assets and relevant payable taxes shall be regarded as the transaction cost, and the difference between the fair value and the carrying value of the asset surrendered shall be recorded into the profit or loss of the current period:

(1) The transaction is commercial in nature;

(2) The fair value of the assets received or surrendered can be measured reliably.

If the fair values of both the assets received and surrendered can be reliably measured, the fair value of the assets surrendered shall be the basis for the determination of the cost of the assets received, unless there is any exact evidence showing that the fair value of the assets received is more reliable.

No.12 Debt Restructuring

Article 10 When a debt is liquidated by non-cash asset, the creditor shall recognize the fair value of the non-cash asset received as the entry value and shall handle the difference between the book balance of the debt to be restructured and the fair value of the non-cash asset received in accordance with Article 9 of these Standards.

Article 11 When a debt is converted into capital, the creditor shall recognize the fair value of the shares to which it becomes entitled as investment to the debtor and shall handle the difference between the book balance of the debt to be restructured and the fair value of the shares in accordance with Article 9 of these Standards.

No.21 Lease

Article 11 On the lease beginning date, a lessee shall record the lower one of the fair value of the leased asset and the present value of the minimum lease payments on the lease beginning date as the entering value in an account, recognize the amount of the minimum lease payments as the entering value in an account of long-term account payable, and treat the balance between the recorded amount of the leased asset and the long-term account payable as unrecognized financing charges.

The initial direct costs such as commissions, attorney's fees and traveling expenses, stamp duties directly attributable to the leased item incurred during the process of lease negotiating and signing the leasing agreement shall be recorded in the asset value of the current period.

The lease beginning date shall refer to the date on which the lessee begins to have the right to use the leased asset.

No.8 Impairment of Assets

Article 6 Where any evidence shows that there is possible assets impairment, the recoverable amount of the assets shall be estimated.

The recoverable amount shall be determined in light of the higher one of the net amount of the fair value of the assets minus the disposal expenses and the current value of the expected future cash flow of the assets.

The disposal expenses shall include the relevant legal expenses, relevant taxes, truckage as well as the direct expenses for bringing the assets into a marketable state.

No.11 Share-based Payments

Article 4 The equity-settled share-based payment in return for employee services shall be measured at the fair value of the equity instruments granted to the employees.

The fair value of the equity instruments shall be confirmed in accordance with Accounting Standards for Enterprises No. 22 - Recognition and Measurement of Financial Instruments.

Article 10 A cash-settled share-based payment shall be measured in accordance with the fair value of liability calculated and confirmed based on the shares or other equity instruments undertaken by an enterprise.

No.16 Government Subsidies

Article 6 If a government subsidy is a monetary asset, it shall be measured in the light of the received or receivable amount.

If a government subsidy is a non-monetary asset, it shall be measured at its fair value. If its fair value cannot be obtained in a reliable way, it shall be measured at its nominal amount.

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