THE HISTORICAL EVOLUTION OF ACCOUNTING IN CHINA: THE EFFECTS OF CULTURE

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ABSTRACT

Many recent studies have proved that China has had inseparable links between their traditional rules, cultural interests and their life style. Culture is the main point for their existence. Hofstede, Gray, Mueller, and some other empiric accounting researchers who emphasize the influence of cultural effects on national accounting improvements said, about China’s Accounting, that there is one function that is distinguished from the other parameters. This most dominant character is “culture”. These characteristic effects are known as “environmental factors” in literature.

This paper attempts to show that Chinese cultural variables (e.g. Confucianism, Feng Shui, Buddhism, Yin-Yang, etc.) have shaped Chinese accounting behavior and techniques. In China, these kinds of accounting components are rooted in traditionally Confucian practices and ancient insights, but they are still effective today. In this paper, the influences discussed from an historical perspective by using cultural variables in China are focused on bookkeeping methods, accounting practices, accounting information, etc.

The evidence from literature also indicates that though the government regimes were changed and economical styles were changed in China, the influence of the characteristics of culture survived in accounting. For instance Yin-Yang polarity is still used for balanced Chinese accounting; however, private sector actions have decreased the number of state-centered businesses and firm. Chinese economic logic has metamorphosed to the market-oriented model practices, but Chinese mysticism keeps its place through the whole land of the People’s Republic of China.

Keywords: Environmental Factors, accounting, culture, China, Confucianism, Feng Shui, Yin-Yang polarity, Single&Double-Entry Bookkeeping Methods.
Outline of Study

This paper aimed the answer of the following:

1- What factors influence Chinese accounting system, also bookkeeping methods and how do they influence the accounting patterns and practices?

2- What is/are the dominant factor/factors of Chinese accounting development?

3- Is environmental factor of “culture” dominant factor of Chinese accounting evolution? If answer is “yes”, what are the reasons?

This paper categorically divided into three parts. First part is literature review. This review emphasizes on the environmental factors for providing a comparison between national accounting elements and international accounting matters and then evaluates the Chinese Accounting system by analyzing certain national and international factors. These analysis generally situate as a prologue for the environmental factors and also help us to determine where the Chinese accounting system have stayed.

Second part attempts to mention the impacts of environmental factors on Chinese Accounting. Especially, it focuses on cultural factors as terms of Confucian patterns, the influences of Feng Shui belief, examples of connection between Yin-Yang principles and bookkeeping methods like Longmen Zhang bookkeeping style, and the causes of national resistance in China against the western methods of bookkeeping which was explored by Weber and presented as a socio-historical model. The arguments of second indicate us Chinese bookkeeping methods have evolved thousands of years; the influence that is recognized as element of cultural factors like economical behaviors is also identified the main effects of influence behind the Chinese accounting evolution.

Third and the last part presents an historical evolution of Chinese accounting, clarifies the subject by telling branch of Chinese writing system, narrates the evolution of Chinese bookkeeping methods from input-output method of single-entry to double-entry, explains the cultural symbols and their influence on Chinese accounting practices, also elaborates bookkeeping methods among the dynasties centuries. In addition, political factors are related to cultural factors. First era were shaped under communist regime pressure and state-centered governance, second era have been shaped by liberalization and market-oriented model. The government called this model ‘Open-Door Policy’. The main point of this policy was to harmonize and modernize Chinese accounting with the westerns technical requirements and management skills. In recent years those policies kept their influence and force Chinese government to publish new accounting standards which are harmonized with international accounting standards. Chinese Accounting System is now closer to International Accounting Standards than the past practice; however it keeps its collectivist, conservative and long-term characteristic or design.
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List of Abbreviations

ASBE : Accounting System for Business Enterprises
FIE : Foreign Investment Enterprises
GAAP : Generally Accepted Accounting Principle
IAS : International Acconting Standards
IASB : International Acconting Standards Board
IFRS : International Financial Reporting Standards
JSLE : Joint Stock Limited Enterprises
MOF : Ministry of Finance
PRC : People’s Republic of China
SME : Small and Medium Enterprises
SOEs : State-owned enterprises
1. Introduction

Environmental influences are the clue of understanding the national accounting system’s ranges. National Accounting is a part of its environment, it is shaped by those effects and it has a volume in International Accounting.

After the 1960s, in international research, there was a tendency which gives a meaning to categorize the countries accounting behavior, like deductive or conductive insight’s criteria. These criteria aim to explain the reasons for accounting differences between national accounting practices. Determinants of International Accounting are shaped around the international accounting tendencies. During the period of accounting improvements around the world, two main designs have been seen, one is deductive approach, and the other one is inductive approach. In one hand, it has been known that Mueller, Choi and Nobes are the few accounting researchers who are recognized in the deductive approach group. In deductive approach, it has been examined the development of accounting by linking the effects to influential environmental factors. On the other hand the representatives of inductive approach, for instance, Nair and Grand, has defined accounting by analyzing the factors and the practices to identify accounting patterns. They made a distinction between measurement and disclosure practices.

Hofstede’s pioneering research in the 1970s was distinguished the process by detecting the structural elements of culture, particularly those that most strongly affect known behavior in the work situations of organizations and institutions. Hofstede mentioned the expressed influence on accounting long time ago and then he focused on culture for analyzing emergence of accounting climate.

1.1 Literature Review

Many researchers asserted that international accounting was not only an important research area in its own right, looking at transnational issues and multinational enterprises, but also important in giving an opportunity to develop domestic research by providing a ‘laboratory’ for the analysis of national accounting issues. Once international accounting became accepted as an important area to be investigated, researchers attempted to identify key environmental factors which influenced and explained accounting diversity and also attempted to classify different national accounting systems and practices. Factors, that might be relevant as the causes of international differences include the main elements named culture, politics,

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2 Ibid.
4 Sidney J. Gray et al., Global Accounting and Control, New York, John Wiley & Sons., 2001, p.42
5 Schradhha Verma, Culture and Politics in International Accounting: An Exploratory Framework, University of London, 2005, p.1
economics, and legal system; additionally they contain the definition of providers of finance, taxation, the profession, inflation, and theory; also the other factors are counted as language, history, religion and education conditions. The question is “Which factor or paradigm forms the accounting environment?”

Culture seems one of the important factor for this design as politics and economics. By Mueller this effect has been seen only. Hofstede attempted to argue the processes of cultural dimension and accounting behavior. Gray developed the link between culture and accounting value; his claim was provided a sense of provability about cultural effect. Culture has dominant character among the environmental influence. Radebaugh emphasized that culture was presented by the change of social system. In addition, Radebaugh and Gray discuss the issue of cultural influence on reporting practice in detail. Through a comparative study, they conclude that despite the existence of standards, each country’s reporting practice is greatly influenced by its culture and history.

1.2. Comparative Accounting and Classification of Accounting Developments

International comparative accounting research has contributed to a growing realization that fundamentally different accounting patterns exist, which are argued to result from environmental differences, and that international classification differences might have significant implications for harmonization and economic integrations. The national accounting practices were enforced to comply with international accounting practices by the international harmonization process of the Accounting Standards. A classification in accounting may also help to shape development rather than merely to describe how things are. Classification facilitates the study of the logic and the difficulties facing harmonization. The harmonization process was seen specifically as a movement of harmonization of commercial laws; but there were a lot of variables which might distort the process, such as national legal systems, culture, taxation system, religion. But the classification variables have to be determined among the most powerfully differentiating factors which is related to measure the national accounting characteristics.

1.2.1. Purposes of International Classification

The classification process is described and compared international accounting systems in a way that will promote improved understanding of the complex realities of accounting practice. The classification should contribute to an improved understanding of the extent to which national systems are similar to or different from

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6 Zhang, Ibid., p.15
7 Zhang, Ibid.
9 Chanchani-MacGregor, Ibid.
11 Nobes, Ibid., p.56
each other, the pattern of development of individual national systems with respect to
each other and their potential for change, and the reasons some national systems have
a dominant influence whereas others do not. The classification help the policymakers
assess the prospects and problems of international harmonization. Policymakers at
the national level will thus be in a better position to predict likely problems and
identify solutions that may be feasible given knowledge of the experience of
countries with similar development patterns.  

1.2.2. Cultural Influence on Accounting Environment

All these studies give an expression about different nations culture is an
important factor that affects the accounting system that is seen and is a factor that
needs investigation. The focus on the role of culture on accounting was first
considered in many international business literature and has become an important
area of research mainly since the 1980’s within international accounting. For
example; Mueller, Nobes, Hofstede, Gray, Jaggi, Choi-Mueller, Bloom and Naciri, Belkaoui, Violet and McKinnon have all worked on culture and
accounting.

1.2.2.1. Mueller, Nobes and Choi

Mueller pioneered the start point of discussions in accounting classification
subjects and recognized a wider set of influences, such as legal system, political
system, and social climate, as relevant to accounting development, though without
offering precise specification. Mueller gave no expressed recognition to cultural
factors, which were presumably subsumed within the set of environmental factors he
identified. Mueller’s further work was about classifying international accounting
which linked to different types of accounting systems. Using assessments of

12 Gray et al., Ibid.
Helm, 1984
15 V. G. Hofstede, Culture’s Consequences: International Differences in Working-Related Values,
Beverly Hills, Sage Publications, 1980
16 V. S.J. Gray, “Towards a Theory of Cultural Influence on the Development of Accounting Systems
Internationally”, Abacus, Volume 24, 1988, pp.1-15
17 V. B.L. Jaggi, “The Impact of the Cultural Environment on Financial Disclosures”, The
International Journal of Accounting, 1973, pp.75-84
18 V. D.S. Fredrick Choi-Gerhard Mueller, International Accounting, New Jersey, Pretince-Hall,
1978
19 V. R. Bloom-M.A. Naciri, “Accounting Standard Setting and Culture: A Comparative Analysis of
United States, Canada, England, Germany, Australia, New Zealand, Sweden, Japan and Switzerland”,
The International Journal of Accounting Education and Research, Volume 24, 1989, pp.70-97
21 V. W.J. Violet, “The Development of International Accounting Standards: An Anthropological
Perspective”, The International Journal of Accounting Education and Research, Spring, pp.1-12
22 V. J.L. McKinnon, The Historical Development of Operational Form of Corporate Reporting
Regulation in Japan, New York Garland, 1986
23 Verma, Ibid., p.3
economic development, business complexity, political and social climates, and legal systems.\textsuperscript{24}

Mueller’s environmental analysis was adapted and extended by Nobes, who based his hypothetical classification on an evolutionary approach to the identification of measurement practices in developed Western nations. However, like Mueller, Nobes made no literal mention of cultural factors. Nobes made a basic distinction between microeconomic and macroeconomic systems, and a further disaggregation between business economics and business practice orientations under the micro-based classification. Under the macro-uniform based classification, he made a disaggregation between a government/tax/legal orientation and a government-economics orientation.\textsuperscript{25}

Mueller and Choi together got a result, they claimed that international accounting concepts are based on derived environmental analysis. This opinion presents that any accounting innovations or development are activated by non-accounting elements and they gave a list that they believed to have direct effect upon accounting developments named as environmental factors.\textsuperscript{26} The factors were attributed to five main factors by the authors: legal, political, economic, cultural and professional factors. Exactly among them, the social climate symbolizes the cultural influence. Cultural influences emphasized by the other researchers in the following periods.

1.2.2.2. Hofstede’s Values and Gray’s Explanation Model on Accounting System Development

Hofstede developed a model of culture which was detailed with “collective programming of mind”\textsuperscript{27}, so culture includes a set of societal values that drive institutional form and practice.\textsuperscript{28} He distinguishes four levels at which culture manifest itself: “The levels of symbols, heroes, rituals and values”.\textsuperscript{29} By these explanation accounting is conceptualized as a system which vary along national cultural lines.

Dimension of culture is constructed in the following topics:\textsuperscript{30}

- Individualism versus collectivism which relates to realitoship between the individual and group with collectivist or loyal values.
- Large versus small power distance which relates to social inequality including realitoships with authority.

\textsuperscript{24} Gray et al., Ibid., p.37
\textsuperscript{25} Gray et al., Ibid.
\textsuperscript{26} Zhang, Ibid., p.17
\textsuperscript{27} V. Geert Hofstede, \textit{Culture’s Consequences:International Differences in Work Related Values}, Beverly Hills, California, Sage Publication, 1980, p.26
\textsuperscript{29} Zhang, Ibid.
• Strong versus weak uncertainty avoidance which relates to ways of dealing with uncertainty, the control of expression of emotion.
• Masculinity versus femininity which relates to concepts of masculinity and femininity, and interests in the social implications of having been born as a boy or girl in any country.

The importance of Hofstede’s dimensions of national culture in the International Accounting is national culture’s influences on the behaviour of accountants and after that, derived behaviors’ affections on the nature of Accounting Practices. The dimensions as individualism and uncertainty avoidance are most significant for Accounting. For example, it was argued that in a country with high uncertainty avoidance, efforts are made to minimise uncertainty. This means in the area of Accounting that rules and regulations tend to be rather explicit, detailed, prescriptive, all comprising and rigid. Individualism affects Accounting in terms of disclosure practices and income measurement rules. Gray, following Hofstede, defined culture as the value system shared by major groups of populations. According to Gray, in a theoretical way, linking accounting and culture within which the impact of culture on accounting values and accounting change could be assessed. Gray’s theory is constructed from the societal values which are originated accounting subculture. The value systems of accountants are derived from cultural or societal values with specific reference to work-related values. Accounting values in turn influence accounting practices, including the reporting and disclosure of information. Thus, depending on the varying degrees of external and ecological forces shaping societal values, different accounting systems develop, reflect and reinforce these values. Accounting values, in turn, affect accounting systems, therefore cultural factors directly influence the development of accounting and financial reporting systems at a national level.

External influences and also different ecological factors through varying societal values are shaped different accounting systems in different parts of the world. This argument support the contention that each culture should develop its own accounting systems to serve its own distinct requirements. Gray went on to suggest that there should be a close match between culture areas and patterns of accounting systems. This is the basis upon which Gray rests his theory of cultural relevance to accounting. Gray extended Hofstede’s model by hypothesizing the existence of an accounting subsystem which drew its value system from the primary societal value system; in the hypotheses which were interested in culture, it was argued that a

33 Verma, Ibid., p.11
36 Willett, Ibid., p.3
37 Salter-Nieswander, Ibid., p.382
combination of accounting sub-cultural dimension have considerable influence on accounting.\textsuperscript{38} Gray developed four accounting values which were based on Hofstede’s model. Gray’s accounting values were represented as follows:\textsuperscript{39}

- Professionalism versus Statutory Control - a preference for the exercise of individual professional judgement and the maintenance of professional self regulation, as opposed to compliance with prescriptive legal requirements and statutory control.
- Uniformity versus Flexibility - a preference for the enforcement of uniform accounting practices among companies and for the consistent use of such practices over time, as opposed to flexibility in accordance with the perceived circumstances of individual companies.
- Conservatism versus Optimism - a preference for a cautious approach to measurement so as to cope with the uncertainty of future events, as opposed to a more optimistic, laissez faire, risk-taking approach.
- Secrecy versus Transparency - a preference for confidentiality and the restriction of disclosure of information about the business only to those who are closely involved with its management and financing, as opposed to a more transparent, open and publicly accountable approach.

Gray classes ten cultural areas according to his four accounting values. First, it is classified that the cultural areas according to their attitudes towards regulations (shown in Figure 2). Hence, the values are put as professionalism versus statutory control and uniformity versus flexibility at extremes. Second, Gray classes the cultural areas according to measurement and disclosure practices. The values are named as conservatism versus optimism and secrecy versus transparency. Thus, in contrary to Nobes, who consider only measurement practices as classification characteristics, Gray differentiates between:\textsuperscript{40}

- Regulation authority in Accounting and
- Measurement and disclosure practices.

The accounting values most relevant to the professional or statutory authority for accounting systems as well as their enforcement appear to be professionalism and uniformity. Both are concerned with regulation and the degree of enforcement or conformity. Accordingly, these can be combined and the classification of culture areas hypothesized on a judgmental basis. In making these judgments, we will refer to the relevant correlations between value dimensions and the clusters of countries identified from the statistical analyses carried out by the researchers.\textsuperscript{41} Gray also proposed hypotheses that linked the accounting values. These hypotheses were an attempt to link cultural values to accounting values which themselves were linked to four aspects of accounting practice Gray’s model was a way of trying to understand the impact of culture on accounting, and a specific level which operationalise the links between culture, accounting values and accounting practices. In particular, Gray suggested that.\textsuperscript{42}

\textsuperscript{38} Yuan Ding et al., “Why do National GAAP Differ from IAS? The Role of Culture”, The International Accounting Conference Athens University of Economics and Business, March 2004, p.10
\textsuperscript{40} Fritz-Lammle, Ibid., p.27
\textsuperscript{41} Gray et. al., Ibid., p.48
\textsuperscript{42} Verma, Ibid., p.14
• professionalism would influence the nature of authority for the accounting system
• the degree of uniformity preferred would influence the way in which the accounting system was applied
• the amount of conservatism preferred would influence the measurement practices within the system
• the degree of secrecy preferred would influence the extent of disclosure in the accounting system

1.2.3. Major Environmental Characteristic: Economic Determinant

Arpen and Radebaugh worked on environmental characteristics conceptual framework, in which environmental characteristics were organized into four major groups to explain the environmental influences on accounting: educational, socio-cultural, legal and political, economical. They claimed that “economic development affects many socio-cultural attitudes and brings about changes in legal, political, and educational objectives and sophistication, each of which in turn can affect accounting practices.”

During the late Qing dynasty, Mao’s era, and the last thirty years in economic transition; economic determinant could have been effective.

1.2.4. Belkaoui: Linguistic Approach on Accounting

Belkaoui presented the most interesting determinants of national differences in international accounting by presenting an international accounting contingency framework to explain these differences: Main elements of framework are: cultural relativism, linguistic relativism, political and civil relativism, economic and demographic relativism, legal and tax relativism. Cultural relativism refers to the need to judge any behavior in terms of on its own cultural contract, and not from another cultural context. Applied to accounting, cultural relativism rests on the fundamental assumptions that accounting concepts in any given country are as unique as any other cultural traits. Cultural relativism is necessary to understand determinants of national differences in international accounting.

2. Epistemological means of Culture in Accounting

Culture isn’t random or haphazard; culture is empirically a multi-faceted concept. In anthropology, different cultures have been related different concepts of responsibility, self and understanding. Hofstede defines culture as the collective programming of the mind which distinguishes the members of one human group from another. Culture provides the cognitive terms for individuals within a group and

43 Zahng, Ibid., p.26
45 Zahng, Ibid., p.27
society preconditions for human behavior. This programming tends to be securely established in an individual by adolescence, but does evolve from generation to generation. Thus, culture is viewed as those beliefs and systematic values that are widely shared in a specific society at a particular point in time. Religion, proximity, history and education are factors that have been identified as important in defining cultural concept.

2.1. Chinese Social Values on Accounting

Hofstede’s statistical analysis and reasoning revealed four underlying societal value dimensions—that is, collective values at the national level along which countries could be positioned. These dimensions, with substantial support from prior work in the field, were labeled Individualism, Power Distance, Uncertainty Avoidance, and Masculinity. Subsequent research by Hofstede and Bond into Chinese values revealed a fifth dimension: a short-term versus long-term orientation, or what was termed Confucian Dynamism. Such dimensions, which we will discuss shortly, were perceived to represent elements of a common structure in cultural systems. Confucian Dynamism as significant cultural value dimensions, it can then be argued that it should be possible to establish their relationship to accounting values. If such a relationship exists, then a link between societal values and accounting systems can be established and the influence of culture assessed. Chow et al. apply the Hofstede cultural dimensions to provide an evaluation of societal values on Chinese Accounting as it configure on Table 1:

Table 1-Chinese Social Values On Accounting

<table>
<thead>
<tr>
<th>Hofstede’s Societal Value</th>
<th>China</th>
</tr>
</thead>
<tbody>
<tr>
<td>Individualism/collectivism</td>
<td>Collectivism</td>
</tr>
<tr>
<td>Power distance</td>
<td>Large</td>
</tr>
<tr>
<td>Uncertainty avoidance</td>
<td>Strong</td>
</tr>
<tr>
<td>Masculinity/femininity</td>
<td>Less masculinity</td>
</tr>
<tr>
<td>Long-term/Short-term orientation</td>
<td>Long-term</td>
</tr>
</tbody>
</table>

Chow et al. described the accounting system and processes in China the current state of the accounting profession, and suggested that accounting measurement and disclosure in China, the development of the accounting systems would be constrained by the influence of China’s culture and its accounting subculture and also claimed that while financial reporting would be governed by

50 V. Geert Hofstede-Micheal H. Bond, “The Confucius Connection: From Cultural Roots to Economic Growth” Organizational Dynamics, Volume 16, No.4, pp.5-21
51 Gray et al., Ibid.
52 Gray et al., Ibid., p.43
54 Gao-Schachler, Ibid., p.44

8
accounting standards, their development and enforcement would remain a governmental and legalistic function.  

2.1.1. The Dominant Factor on Accounting Evolution in China: Culture

In the recent research, most researchers claim that ‘culture’ is the dominant factor among the environmental influences in China for Accounting Evolution. According to some researchers: “Chinese accounting strongly depends upon its culture.” In the following arguments, researchers classified Chinese culture into two parts:

- Chinese traditional culture (was rooted in the Confucianism and Buddhist philosophy and handed down from generation to generation)
- Chinese modern culture (was encrypted and created in the light of socialist structure)

There are six major traditional culture elements that affect Chinese accounting system and practices: Theory of Opposing Yi (justice) and Li (profit); Opposition of Trusts and Contracts; The Dogmatic Attitude; The Conservative Thought; Collectivism; Religion. Figure 1 attempts to indicate the influences of traditional culture on Chinese Accounting system.

Figure 1-Cultural Factors Rooted From Tradition Influencing Chinese Accounting

<table>
<thead>
<tr>
<th>Cultural Factors and its influences</th>
<th>Chinese Accounting</th>
</tr>
</thead>
<tbody>
<tr>
<td>Feng Shui beliefs</td>
<td>*Single-Entry Methods: -Cao Liu Form</td>
</tr>
<tr>
<td>Yin&amp;Yang concepts</td>
<td>-Cao Liu ve Zong Qing</td>
</tr>
<tr>
<td>Confucianism</td>
<td>-Three-Column Method Of Calculating Ending Balance</td>
</tr>
<tr>
<td>- Confucianism</td>
<td>-Four-Column Method Of Calculating Ending Balance</td>
</tr>
<tr>
<td>*Three-Feet Bookkeeping Methods</td>
<td>*Double-Entry Methods: -Longmen Zhang</td>
</tr>
<tr>
<td>- Confucianism</td>
<td>-Four-Feet Bookkeeping</td>
</tr>
<tr>
<td>Feng Shui</td>
<td>-Tian Di He Zhang</td>
</tr>
<tr>
<td>Accounting Information:</td>
<td>-Users – emperors and government administration</td>
</tr>
<tr>
<td>- Confucianism</td>
<td>-Contents – government budget and taxation</td>
</tr>
<tr>
<td>Feng Shui</td>
<td>-Accounting information and Feng Shui consequence</td>
</tr>
<tr>
<td>- Confucianism</td>
<td>Accounting Regulations:</td>
</tr>
<tr>
<td>Feng Shui</td>
<td>-Highly developed government accounting rules</td>
</tr>
<tr>
<td>- Confucianism</td>
<td>-Government control in standards-setting</td>
</tr>
<tr>
<td>Buddhism</td>
<td>-No written private accounting standards</td>
</tr>
<tr>
<td>- Confucianism</td>
<td>Accounting Profession / Accountant</td>
</tr>
<tr>
<td>Buddhism</td>
<td>-The status of accounting profession</td>
</tr>
<tr>
<td>- Confucianism</td>
<td>-Government accounting officials – noblemen</td>
</tr>
</tbody>
</table>

55 Chancani-MacGregor, Ibid.
57 Zhang, Ibid., 48
58 Zhang, Ibid.
59 Gao-Schachaler, Ibid., p.54
Private accountants – non-skilled profession

Government Accounting:
- The role in government system
- Highly developed government accounting
- The function

Private Accounting:
- The function
- Accounting without profit determination
- The role in the society

And the most predominant modern cultural influences on accounting are:

- The state theory (which decides accounting objectives, functions and organizations);
- The class theory (which lead accounting to political oriented argument over accounting with class characteristics);
- Marxism (which becomes the basic concept of accounting, the theoretical accounting, and decides the development of accounting);
- The Cultural Revolution (which strongly discriminated against accounting and accountants).

The researcher claimed that The Chinese accounting system levels have been built according to its traditional and modern cultural frames. However, today’s Chinese accounting depends not only on its own cultural values, but also to some extent on culture exchange as on the western cultures. Figure 2 attempts to give a general insight about the factors influencing the evolution of Chinese accounting, during the Chinese history.

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60 Zhang, Ibid., 49
61 Zhang, Ibid.
62 Gao-Schachler, Ibid.
2.1.2. Key Concepts of Chinese Culture and Feng Shui

When considering the various influence upon the quality of life, the Chinese have a quintessential idiom: “First destiny, second luck, third ‘Feng Shui’, fourth philanthropy, fifth education. Since there is no way we can change our destiny and luck, and despite the fact that Feng Shui ranks third, it is important to Chinese consciousness that it has become top amongst other elements that can be modified and that are within human intervention in order to lead a better life. It is also believed that with proper orientation of one’s house or business premises, one is able to harmonize with heaven and earth; relate to the physical surroundings to attract desirable cosmological influences by intervening with Feng Shui. 63

2.1.3. Cultural Components of Chinese Strategy

‘Dao Jia-The Way’ of universe system thinking guided by Dao. The principles of Bing is adopted to form the shadow strategy. The strategy is translated into programs and policies and subsequently executed and monitored wit reference to Fa rules. The burden of building a harmonious and learning organization rests on Ru which aims to create a Confucian shaped culture, with a heavy dose of ‘Yi-Change’, around the institutional structure.64 Ancient Chinese thoughts are merged the new strategic paradigm of China. Figure 3 also presented this emphasis on cultural components which were also taken their roots from Chinese four major schools of thoughts: Dao Jia (The Way), Bing Jia (Military), Fa Jia (Law), Ru Jia (Confucius).

Figure 3-Cultural Components of Chinese Strategy

2.1.3.1. Who is Confucius? Accountant or Philosopher in the East Part of the Paradise

Confucius grew up poor. As an adolescent, he did accounting work at his country. Confucius was bent on self-learning and improvement. Confucius travelled from state to state in China to encourage leaders to pursue his philosophy, for this

63 Jimmy F.M. Cheng,  A Fundamental Study of How Chinese Thinking Influences Westerners and Managerial Practices, Hong Kong School of Business Research Project, August 1996, p.32
64 Cheng, Ibid., p.41
reason, he established a school to train leaders, also taught them Chinese history and classical literature. For those feudal times, there has been a complete lack of law in his society, feudal wars were prevalent. Anarchy was degenerated the society. Pessimism about the future was common. In these circumstances, Confucius attempted to provide a new and regular society. He offered new social patterns which were the fundamentals of human nature, values, and also ethics, etc. Therefore, Confucianism means loyalty, filial piety, benevolence, righteousness, honesty, etc.  

2.1.3.2. Confucianism

Traditional Chinese cultural values, as presented by Confucianism, Taoism and Buddhism, consist of a sense of order, vertical and horizontal relation between obligations to the group, and a preference for harmony and cooperation. The emphasis is on the status quo. The philosophical foundations of Chinese culture differ substantially from various philosophical traditions. Confucian philosophy forms the essential basis of Chinese culture. According to Confucian doctrine, an individual is perceived as being a part different overlapping social networks and there are highly defined rights and obligations attached to the relative position each individual in such networks. Confucianism emphasizes the family as the base of a person’s operation and also as an ethical unit of society. At the top of the Confucian ethical system is the concept of filial piety which defines the relationship between parents and children.

Confucian thought is ‘Wu Lun-five cardinal role’ relations between emperor-subject, father-son, husbands-wives, elder-younger brothers, friend-friend. Regulating these social relationships are the five Confucian virtues of Ren (humanity-benevolence): Yi(righteousness), Li(propriety), Zhi (wisdom) and Xin (trustworthiness). The definitive ideals set the norms governing how individuals act and behave each other in a social hierarchy. It should be noted that Confucian philosophy is not a utilitarian philosophy: material interests are directly in conflict with the dictates of virtues of Wu Lun. At the top of the Confucian ethical system is the concept of filial piety which defines the relationship parents and children, as it is seen Mencius thoughts, he said.

“The content of benevolence is the serving of one’s parents; the content of dutifulness is the obedience to one’s elder brothers; the content of wisdom is to understand these to hold fast to them.”

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66 Gao-Schachaler, Ibid., p.44
67 Gao-Schachaler, Ibid., p.45
68 Velayutham-Perera, Ibid., p.68
69 Gao-Schachaler, Ibid.
70 Velayutham-Perera, Ibid.
2.1.3.3. Feng Shui, Confucian and Yin & Yang Based Philosophy and Their General Effects

The concept of Yin & Yang was derived from the ‘I Ching-Changes’ and five elements, and came from the influence of the ancient magician (fang-shih). This ancient magic used the form of divination including six classes: astrology, almanacs, the five elements (fang), divination plant (shih) and the tortoise shell (kuei); miscellaneous divine uses, the system of forms (hsing). The combination of these two fundamental systems provides the explanatory basis for the formation of the cosmological symbols which have correlation in the corresponding human world. This is further correlated with the philosophy of the unity of man and nature which conforms to the conflicting philosophical currents, such as, the Confucian moral values, Taosit way, the numerologist wilful heaven, and astrological order.

The ancient Chinese believed that the cosmos was in perpetual flux, motions and change. It is called ‘Tai Chi’. Briefly, ‘Tai Chi’ includes the means of change and transformation. There are three kinds of ‘Chi’: ‘Sheng Chi’, ‘Si Chi’, ‘Sha Chi’. ‘Sheng Chi’ means moving upward; ‘Si Chi’ means dying or waning; and ‘Sha Chi’ means a harmful energy. The cosmos is organized by two concepts: named Yin & Yang. They are regarded as the two cosmic forces that shaped and managed the life. These two opposite forces change each other over time. Yin will eventually become Yang, Yang will eventually become Yin; the system provides the balance concept.

Some researcher argues that mainstream accounting research represents Yang orientation without balancing of and by the Yin, and that alternative accounting research to the mainstream is a necessity for establishing a balance between Yin & Yang.

Yin & Yang are interconnected like different, but inseparable sides of cosmos. e.g. Yin is like night, Yang is like daytime; night take the place of daytime and moon take the place of sun. This is similar to input-output activity in organizations and transformation of organizational transactions like providing balance between profit and loss.

It is taught that this feature has considerably influenced the styles of Chinese people’s thinking development. In addition Confucianism was very much influenced by the Yin & Yang relationship and always suggested a ‘middle way’. The ‘middle way’ originated from Yin & Yang balance, and it means understanding the inevitability of changes being prepared to make the necessary adjustments in whole life to maintain harmonious and balanced stance. For this reason, it is thought that Yin & Yang, Feng Shui and Confucian Philosophy intend to be occurred conservative comprehensions in Chinese life style and made them conservative.

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Confucian philosophy forms the basis of the Chinese cognitive attitudes, which have also influenced the development of Chinese bookkeeping and accounting practices. Conservatism emphasizes conformity to the status protection of the larger social order. Conservatism also attracts the progress. During the evolution of Chinese accounting, slow progress and change was seen as the main characteristic of Chinese accounting.  

2.2. Approach of Conservatism or Struggling Against Uncertainty by Long-term Performance

Confucian doctrine means exactly taking a middle road approach against the uncertainty. The emphasis on adherence to time-honored rituals and traditions Confucianism would seem to suggest an accounting system that was characterized by form and structure, stressing conformity to customs and traditional practices rather than innovative new process. Confucianism can lead to an accounting system with attributes of nepotism and secrecy. Because of that, the family firm would generally prefer non-disclosure. Another approach deal with uncertainty in accounting, named income smoothing, which involves an attempt to stabilize earnings by tempering peaks that would generally occur in income performance measurement. Conservatism is seen as an active approach for coping with risks, showing losses as soon as reasonably possible, but deferring gains till they are clearly realizable. Income smoothing can be considered consistent with Confucianism inasmuch as focus on long-term, not short-term performance.

Another example of such an influence on conservatism was determination of earnings in the Longmen system. Two kinds of inventory practices prevailed around the sixteenth century: appraisal of inventory and highest price method. Under the former, the cost of goods sold in current period was determined by an appraisal of inventory at the ending date, based on:

\[
goods \text{ sold} = total \text{ purchases} + ending \text{ balance} - beginning \text{ balance}
\]

under the highest price method, the cost of goods sold was determined by the highest price of merchandises purchased in the period. The highest price method was more popular in accounting practice at that time, which apparently was conservative approach.

2.2.1. Moral Effect of Confucianism on Chinese Accounting

Chinese traditional cultural ethics does not endure profit motive and desire. The moral notion of Confucianism focused on Yi (justice) while common people think about Li (profit) was an ethic directing people’s behaviour in Chinese history of over thousands of years. In traditional Chinese culture, Yi and Li were opposite.

76 Gao-Schachaler, Ibid., p.48
77 Bloom-Solotko, Ibid., p.31
Desire for profit was accepted as an evil for the society. Confucian Wu Lun condemned any link of profit making and commercial activities with a nobleman.  

2.2.2. Yin & Yang Influence on Chinese Accounting

In the traditional way of Chinese thinking, Yin & Yang are stated as an aspects of one and ultimately the same system, (i.e. spirit or body, etc.) and the disappearance of either one of them would be destroyed the system. Under this influence, Chinese accounting was developed with clear-cut distinction between accounts, but the balance was strongly embed. As observed on the Longmen bookkeeping method, the most advanced double-entry bookkeeping in the accounting history reflects a lack of distinctive separation between the liabilities and capital earnings. The basic principle of Chinese bookkeeping is that cash flows should be equal to cash outflows.

The influence of the Yin & Yang can also be seen in the naming accounting technique of both Longmen Zhang bookkeeping, which emerged at the end of the Ming and the beginning of the Qing dynasties; and Tian (Heaven-Earth) He (Matching) Zhang (Bookkeeping System), which emerged in the middle of the eighteenth century. The most popular Feng Shui, ‘Tian-Di’ and ‘Longmen’, were in fact used to name these bookkeeping. Another sample for the influence of Feng Shui terms is observed at the relation of Yin & Yang balance. Under the Longmen bookkeeping system, process was started with Tian Fang (the heaven-indicates Yang), continued with Di Fang (the earth-indicates Yin), and the process balanced with both of them was called Tian Di He, which means to match or balance the heaven (Yang) with the earth (Yin).

2.2.3. Collectivism and Uses of Accounting Information

“Collectivism represents a preference for a tightly-knit social framework.” Collectivism is defined as the subordination of personal goals to the goals of work group with an emphasis on sharing and group harmony. Therefore, Chinese culture is defined as Confucian dynamism which epitomizes Eastern value-system, particularly Chinese value. It differs from Western value-system with its derived identity which originated from the ties of group sensibility.

The Chinese culture is basically characterized by collectivism which is very group or mass oriented. The characteristics of collectivism have signed impact on the development of Chinese accounting. First, under a collectivist society the users of accounting information were predominantly government administrative bodies with macroeconomic interests. The primary purpose of accounting was to keep track of the flows on Emperor's wealth and the state's properties as economic efficiency.

79 Gao-Schachaler, Ibid., p.51  
80 Gao-Schachaler, Ibid., p.54  
81 Gao-Schachaler, Ibid.  
82 Gao-Schachaler, Ibid.  
83 Velayutham-Perera, Ibid., p.72  
Second, information provided by accounting was mainly statistical data that considered as part of government census. Cost measurement and profit calculation were rarely found in ancient Chinese accounting system. This is Confucian LI and Yi opposite ethics prevented Chinese accounting from measuring and disclosing profits and loss. Before the Tang dynasty’s period, accounting practice varied from state to state and region to region as the terms of measurement and bookkeeping. As a result of the variation of bookkeeping and measurement, it was difficult for merchants to use and activate the means of exchange (e.g. cloth, silk, salt, grain, rice, etc.) and to evaluate performance of product trading, a kind of barter.

There were huge amounts of paper being used in preparing accounts. Due to high amounts of pieces of paper using for annual reports, the Tang dynasty’s authorities began to reform accounting reporting by implementing various new rule and laws. According to those times governmental standards, a standard form of statement called Changxingzhi, was capturing a regular implementation with two pieces of paper which contained accounting information on annual income and expenditure. This was to be used nationwide by local reporting officials. It marked an important stage in unifying the formation of accounting statement at the governmental statement. Afterwards Ming dynasty and Qing dynasty, there given some significant development respectively; which were the publication of unified governmental financial reports named Wanli Accounting Report and Guangxi Accounting Report.

Chinese culture made Chinese people obedient; because they prefer comply with the rules rather than accepting innovations. Therefore, it might be thought that Chinese noblemen including Confucian doctrine kept the middle way notions on whole country, and for a long-term period, this effect caused to be avoided private accounting requirement by widespread governmental accounting practices.

2.2.4. Effects of Chinese Philosophy On Accounting

Chinese philosophy was introspective and mainly ethical; its academic scope was officially restricted and a traditionalist ideology discouraged creativity and innovation. Moreover, at the height of its power and prosperity, China had no need to contemplate change towards western concepts and practices. The country had a stable social structure, a powerful central government and no political opposition. For many centuries China embraced bureaucratic feudalism supported by a unified system of ideological control. This structure had a built-in quality of stability, it was resistant to change and it did not tolerate creative and unorthodox thinking. Anti-mercantile values and structures inhibited the growth of the commercial class, capitalist enterprise and western accounting techniques.

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85 Gao-Schachaler, Ibid., p.57
86 Gao-Schachaler, Ibid., p.58
87 Gao-Schachaler, Ibid.
2.3. Weber’s Model: Stagnation on Accounting in China

Weber prescribed to western double-entry bookkeeping method as an important actor in the history of capitalism. Weber’s classic study *The Religion of China* sought to answer why traditional China’s considerable, political, technical, cultural and social potential for economic growth had somehow failed to ripen by comparison with the west.\(^9\) Weber’s thesis is way of claiming that culture makes all the difference.\(^9\) Weber explained two major forms of economic action: *formal* and *substantive rationality*. Formal rationality is considered value neutral and refers to matters of fact and to a scientific-technical sphere of life.\(^9\) Substantive rationality is an evaluative concept denoting the degree to which an economic system; as the capitalist markets, rational enterprises, accounting; provides for the needs or values of a specific social group.\(^9\)

Half a century of western expansion in China (1840-1890) forced traditional Chinese ideology to experience a searching self-examination and re-evaluation in a reintegration of the country. Reformers were guided by slogans, as “Chinese culture is spiritual, western culture is material”. This way of thinking was used to confirm the so-called Self-Strengthening Movement from 1861 to 1895. Harmony was to remain as the essential core of Chinese ideology in order to maintain a stable and tradition-oriented society in China before the turn of the twentieth century.\(^9\) Weber claimed that China’s failure to develop a rational bourgeois capitalism was due to the absence of a ‘particular mentality for the needed motivation.’ There was also distinguished content between Confucianism and Puritanism which represent comprehensive but mutually exclusive types of rationalism: it was the working out of the pervasive differences in mentality that promoted capitalist development of west and impeded it in China.\(^9\)

The Chinese merchants lack of cultural and ideological independence from the gentry; imperial consensus that relates to accountancy emerges mundane issue of the choice of writing materials. Adopting western bookkeeping methods would have required the replacement Chinese writing patterns with western ones. Chinese were using calligraphy instead of orthodox uses. The written characters, which included numerals, were imbued with the mystical significance and such were all important markers of Chinese culture.\(^9\)

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90 P. H. H. Vries, “The Role of Culture and Institutions in Economic History: Can Economics be of any Help?”, p.6
3. Chinese Accounting History

The accounting researchers assert that Chinese accounting history might begin nearly three thousand years ago and has been as old as ancient Egypt accounting in Mesopotamia. During the past periods, Chinese accounting has started with the assets which were designed an advance level and this level have provide to set up the base of accounting and auditing tradition. In the search for the invention of writing it has been seen that there was a link between writing, abstract counting and accounting. It has also been argued that cuneiform writing was originally created for the exclusive purpose of recording economic transactions and the cuneiform envelope containing tokens used for accounting purposes. There were clay tablets which are signs. They consist of numerals and symbols that are pictographic or quasi-pictographic.

3.1. B.C.: Exploration of Accounting

The embryonic stages in China, Accounting was developed in order to manage and protect property accumulated in production. In first historical stage of China (circa 2000-1500 B.C.) was transformed from a primitive to a slave society. In this era, Kuaji which meant preliminary accounting was get the method of bookkeeping. This type of record keeping elements was providing to gather and compare achievements among dukes and princes; thus accounting could be considered to have had its origin in these early records.

At the later stages (circa 1500-1000 B.C.), the character of system was become more sophisticated. As the result of the emperor’s divination, the number of animals and other rewards had given to officials or offered to gods and ancestors, such information was written down. The decimal system was also mastered and numbers large as 30,000 were used. This period was recognized as the embryonic phase of Chinese accounting.

The Western Zhou Dynasty (circa 1100-700 B.C.) was extent of the slave system period. The amount of land, number of slaves and other rewards continued to grant and describing the awards reflected the ruler’s power and definition of system’s virtues. With the development of agriculture, the annual grain harvest reached very much, that means to calculate and record the amounts were more difficult than the past practices.

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99 Zhao, Ibid.
100 Zhao, Ibid., p.166
101 Zhao, Ibid.
3.2. The Emergence of the Chinese Accounting Climate

Among the historical documents, the book of Menfucius is the earliest one to include the sentence for accounting. It says that Confucius’s job was to do proper accounting. Confucius so as to affirm that the Chinese word for accounting had already appeared during the Spring and Autumn Period. Confucius was a minor official managing warehouses. By proper accounting he meant that the record of receipt and disbursement of materials in the warehouse had to be correct and up to date. In those era(circa 700-220 B.C.) officials had ability to manage and look at the accounts; State have been managed by laws and statements so as to provide conformity and check the achievements by examining accounts. It was related to determine whether the records and bookkeeping were true and reliable. Uniform tax systems were been activated and used at that times.

3.3. Chinese Accounting Books

Before 1850s three account books had formed the basic structure of the Chinese accounting system: the cao liu (memorandum), xiliu (journal) and zongqing (ledger). The standard Chinese book preparation practice was to write characters in vertical column from top to bottom, beginning from the right-hand side of page. A peculiarity of accounting the Ming-Qing period(1368-1911) was the parallel use of three different kinds of numerals: the caoma numerals (the commercial form), hanti numerals (the standard forms) and kuaji ti numerals (the accounting form), which were used in the books of accounts respectively.

3.4. Basic Stages of Chinese Bookkeeping Methods

Bookkeeping progressed very slowly in ancient China due to the low level of commercial activities. Originated from Confucian ideology, commerce was a highly despised activity in ancient China, and merchants were ranked among the lowest in society. It’s not surprising for centuries after its invention, the single-entry system remained a sufficient bookkeeping method for both governmental and private accounting. There were five traditional stages for accounting bookkeeping methodologies in China, which had seen and transformed respectively in middle age dynasties era: ‘Ru-Chu’ (three-column balancing method), Shizhufa (four-column balancing method), Sanjiao zhang (three-feet bookkeeping), Longmen zhang (dragon-gate bookkeeping), Shijiao zhang (four feet bookkeeping).

The three column method was further developed into the four column which was first applied during the Tang dynasty (AD 618-907) and it was a single-entry system. The four column method was expressed in the following formula:

{\text{Formula}}
Jinguang (the previous balance period) + Xinshou (the newly received)
– Kaichu (payment) = Shizai (closing balance)

Four column bookkeeping method was popular at the age of the Song (AD 960-1279), Ming (AD 1368-1644) and Qing (AD 1644-1911) dynasties; it became the standard reporting format both for government and non-government accounting.  

It was the basis of state accounting in late imperial China. Following innovation in commercial and trading activities after the Ming Dynasty, single-entry bookkeeping method transformed itself by the complications of business transactions. The three-feet bookkeeping method was explored middle of fifteenth century. This recording system was given the name ‘three-feet’ from its use of double-entry for claims and transfers and also single-entry for cash transactions. The three-feet method further evolved into the four-feet bookkeeping at late fifteenth, which was the first form of Chinese double-entry bookkeeping. However, double-entry methods were not widely used in China until the nineteenth century. The development of dragon-gate bookkeeping which was derived from the three-feet bookkeeping was promoted during the late Ming and early Qing dynasties. The main feature of this system was its balancing equation:

Jin (Revenues) – Jiao (Expenses) = Cun (Assets) – Gai (Owner’s equity and liabilities)

The other significant development in the progress of Chinese accounting was the emergence of four-feet bookkeeping in the eighteenth century. It was more advanced system than the previous bookkeeping methods for the account classifications. The four-feet bookkeeping recorded all transactions in double-entry form; both cash and non-cash, in two corresponding accounts in the journals or ledgers. The end products consisted of two accounting reports:

- the caixiang report (profit and loss statement)
- the cungai report (balance sheet)

3.5. Accounting at the Qing Dynasty or After the Opium War

After the First Opium War (1840), China fell step by step to a semi-colonial, semi-feudal society. Reforms was executed in all respects as to the forms and formulas practiced in the royal court, national politics administration and finance. Part of the reform of the system of accounting and auditing was to replace the Ministry of Revenue by the Ministry of Finance and Expenditure, which was responsible for transportation of grains, taxation, market management, business and

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110 Chen, Ibid.
112 V. J. Ge, Basic Accounting Principles, Beijing, Jingji Kexue Press, 1986
114 Zhao, Ibid.
115 Auyeung-Ivory, Ibid.
116 Auyeung-Ivory, Ibid., p.11
117 Auyeung-Ivory, Ibid.
118 Zhao, Ibid., p.182
transportation, storage, official salaries, military funds, management of expenditure, and accounting. Also Government accounting adopted debit and credit bookkeeping to achieve budgetary control. Therefore, statements and annual final accounts with documents of receipt and disbursement had to be submitted monthly to auditing offices for verification.\textsuperscript{119}

As a result of massive changes in the nature, scale and sophistication of economic activities in China at the second half of nineteenth century, Chinese bookkeeping methods became insufficient and lost their efficiency. In particular, the formation of joint stock companies increased the demand by absentee investors for accounting information. The elements of the Chinese old accounting methodology was not use to prepare to measure the profit for financial reporting purposes. The logic of new trade required financial instructions to ensure payment, take deposits and provide credit, and also required promissory notes which were not orders for payment, but instruments of credit.\textsuperscript{120}

China’s early efforts on resistance was about modernizing its accounting system. The modernization program planned to assimilate western bookkeeping methods through coded in the Commercial Law, newly established education institution, the publication of textbooks, and the application its methods in the public and private sectors in order to resist against the foreign powers in commercial and industrial warfare.\textsuperscript{121}

Until the introduction of western accounting methods in the second half of the nineteenth century, Bookkeeping in Qing dynasty shaped these basic modes:\textsuperscript{122}

\begin{itemize}
  \item the majority of small and medium sized commercial institutions and old style banks used single-entry systems based on the \textit{shizhufa}, while a minority employed the \textit{sanjiazhang}.
  \item small number of large-scale commercial establishments employed the \textit{longmenzhang} or improved version of it.
\end{itemize}

In the late nineteenth and early twentieth century, Lots of Chinese pawnshops used seven different types of business ledger; the most important one named \textit{dianzhang} was a monthly pawn ledger, to record track of their goods; also the other types of ledgers existed to keep share capital, because pawnshops were often partnership, in-house expenses, individual accounts, and daily exchange rates. Compared their peers in the other trades, pawnbrokers had a superior reputation for accounting probity.\textsuperscript{123}

\begin{flushright}
\textsuperscript{119} Zhao, \textit{Ibid.}, p.184
\textsuperscript{120} Auyeung-Ivory, \textit{Ibid.}, p.12
\textsuperscript{121} Auyeung-Ivory, \textit{Ibid.}
\textsuperscript{122} Gardella, \textit{Ibid.}, p.324
\textsuperscript{123} Gardella, \textit{Ibid.}
\end{flushright}
3.6. China’s Accounting Development and Accounting Profession At the Beginning of 20th Century

The evolution of the accounting profession in China was influenced by the economic, political, cultural and social environment. After the Qing Dynasty was overthrown by a revolution in 1911, the feudal economic system began to disintegrate. Foreign investors came to China and business activities with the rise of west. Such development attracted foreign certified public accountants into China, and in 1918 the Chinese government issued the Provisional Rules for Accountants. Professional public accountants first appeared in China in 1918 when the Northern Warlord government issued the Accountant Provisions, stipulating that anyone who was qualified in accordance with the provisions could apply to the government for a certificate. After passing examination organized by government, a qualified accountant would be able to directly run an accounting firm, and offer accounting services to the clients. This was the beginning of professional accounting in China. Also at this time, it was seen modern accounting educations in the university levels, and contemporary accounting texts were introduced by establishing double-entry bookkeeping. Legislation in finance and accounting were also improved by some laws. Those were the chronological index of the laws which were publicized before 1949: Accounting Law (1935); Auditing Law (1938); Budgeting Law (1938); Final Accounts Law (1938); Public Depository Law (1938). The Civil Government published the Unified Accounting System for All Departments in Central in July 1937.

3.7. The Era of Mao and Communist Accounting System

The development of China’s accounting stopped and changed to a new direction in 1949, when the Chinese Communist Party established People’s Republic of China. It was the new phase of Chinese accounting. China mainly adopted examples from the Soviet Union at first and drew up accounting regulations for various levels of economic departments. China corrected and improved on these examples in the light of China’s specific conditions and requirements, and simultaneously adopted good ideas in accounting from the west. China established a unified accounting system with specific Chinese cultural characteristics. In addition, Maoist advocated the policy of self-reliance and rejected western learning as undesirable. In order to facilitate a Soviet-style centrally planned economy, the Chinese accounting system during the Maoist era was largely a macro-oriented system with control focus. Its primary function was to provide financial information on the use of state funds to both the enterprise management and government ministries. Little attention was given to profit measurement and the long-term viability of economic entities.

124 Helen Yee, “The Concept of Profession: A Historical Perspective Based on The Accounting Profession in China”, Deakin University-Accounting History International Conference, 2001, p.16
125 Zhao, Ibid., p.184
126 Zhang, Ibid.
127 Zhang, Ibid., p.70
128 Zhao, Ibid.
129 Auyeung-Ivory, Ibid.
130 Auyeung-Ivory, Ibid.
Mao Zhedong initiated the Cultural Revolution in 1966, following five years of natural disasters during which the Chinese economy suffered enormous losses and agriculture and manufacturing almost totally collapsed. The stated purpose of the Cultural Revolution was to eliminate all traditional Chinese culture; the real purpose, however, was to cleanse the Communist Party of all of Chairman Mao’s political opponents. This Revolution completely destroyed the weak Chinese economy. Production of goods and services, government affairs, and education all came to a halt. Development of the accounting system was suspended.131

3.8. ‘Open Door’ Policy: New Accounting Era with Deng

Press with the vital problems of widespread poverty and dire backwardness for thirty years of Communist rule, Deng challenged Mao’s political rationality and improved a new policy called ‘Open Door’. In addition, China enacted numerous commercial laws in the early years of Deng’s modernization movement: The Equity Joint Venture Law, The Foreign Enterprise Law, The Patent Law, The Trade Marks Law, The Corporations Law, various tax laws.132

Deng’s transformation of China is named as ‘socialist market economy with Chinese characteristics’.133 As China develops a new economic system, labeled as ‘socialist market economy’, it has chosen to liberalize the economic sphere while maintaining a tight grip on the state-owned core. Reforms have been carried out incrementally by sector, beginning with agriculture and extending to the industrial sector. This method of initiating institutional change on the margin has resulted in higher growth rates during the transition than those achieved by more radical alternatives which emphasized privatization at the expense of institutional development. The efficient provision of strategic services, including information services such as accounting, is the key of sustaining momentum in transition. Under the command structure, prices were set by a central pricing board relying on cost data provided by an accounting system designed to report aggregate statistics regarding plan fulfillment. Cost calculations were therefore relatively inaccurate and subject to political manipulation. As the transformation to a market economy progresses, setting meaningful prices requires that cost accounting be developed into an independent discipline and not merely an appendage of a rigid financial reporting system.134

3.8.1. Impacts of Economic Transition

The impacts of economic transition on Chinese accounting were described at three topics: the definition of business entity, the role of the market, and the

132 Auyeung-Ivory, Ibid., p.22
134 Rask-Chu-Gottshang, Ibid., p.80
accumulation of capital.\textsuperscript{135} The development of autonomous enterprises was intended to lead to redefinition in accounting terms of the boundaries of the firm. In practical terms, to limit the horizon of accounting to the boundaries of each enterprise separately negated the concept of a unified accounting system orientated mainly towards macro-economic needs. The business entity concept, under which an enterprise is deemed to exist independently of its owner for the purposes of external financial reporting, is less relevant under central planning than in a market economy. In communist China, the national economy or a sector of the national economy was the accounting entity, rather than the individual enterprise, which was represented by an accounting sub-entity.\textsuperscript{136}

3.8.2. Reforms in China: Comparison Between Pre-Reform and Post-Reform

The 1992 reform reconstructed the financial reporting system. It can be summarized in four points: replacement of the fund balance statement by an Western-type balance sheet; introduction of a statement of changes in financial position; reduction of the number of statements, including the abolition of the cost and charge structure statement; compulsory inclusion of the notes and ratio analysis.\textsuperscript{137}

The evolution toward market economy in China overwhelm totally the old accounting system in different aspects, such as the revenue recognition, the cost structure and wages, conservatism and provision, fixed assets, etc. For example; fixed assets on a Chinese communist enterprise’s balance sheet included equipment, buildings, machinery and any other long-term assets costing. Land could not be included in the balance sheet, because the State was considered the country's only legitimate owner of land. Assets were valued according to the strict historical-cost principle, with sporadic revaluations based on the national economic plan.\textsuperscript{138} The recognition of the capital in China after the economic reform changed totally the function of financial statements, both for balance sheet or for income statement. In the communist economic system, one of the main accounting functions was to safeguard property owned collectively by society and entrusted to enterprises. The balance sheet was then used to show the structure of the state-allocated funds (on the liabilities side) and the status of these funds in the firm (on the assets side). Table 3 indicates the changes of formats in balance sheet after the transition economy in China:\textsuperscript{139}

\begin{table}[h]
\centering
\begin{tabular}{|c|c|}
\hline
\textbf{Year} & \textbf{Change} \\
\hline
1992 & Introduction of a statement of changes in financial position \\
1993 & Reduction of the number of statements, including the abolition of the cost and charge structure statement \\
1994 & Compulsory inclusion of the notes and ratio analysis \\
\hline
\end{tabular}
\caption{Changes of formats in balance sheet after the transition economy in China}
\end{table}

\textsuperscript{135} Chiapello-Ding, Ibid., p.19
\textsuperscript{136} Chiapello-Ding, Ibid., p.20
\textsuperscript{137} Chiapello-Ding, Ibid., p.23
\textsuperscript{138} Chiapello-Ding, Ibid., p.26
Table 2-Changes of Balance Sheet Format at Pre–form and Post–Reform Times

<table>
<thead>
<tr>
<th>PRE-REFORM ACCOUNTING SYSTEM</th>
<th>POST-REFORM ACCOUNTING SYSTEM</th>
</tr>
</thead>
<tbody>
<tr>
<td>FUND BALANCE STATEMENT</td>
<td>BALANCE SHEET</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>Fund Application</td>
<td>Assets</td>
</tr>
<tr>
<td>Fixed Assets</td>
<td>Liabilities &amp; Equities</td>
</tr>
<tr>
<td>Current Assets</td>
<td>Fixed Assets</td>
</tr>
<tr>
<td>Specific Assets</td>
<td>Intangible and Other Assets</td>
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<tr>
<td>Total</td>
<td>Total</td>
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</tbody>
</table>

**Conclusion**

Chinese people is always seen their life in a long-term perspective in all ages of history, they have given an expression on tradition in order to provide peaceful and reliable environment and they have resisted against the changes secretly. In this paper, the influences discussed from an historical perspective by using cultural variables in China are focused on bookkeeping methods, accounting practices, accounting information and it is concluded that Chinese cultural influences are dominant factor of shaping the Chinese accounting. In China, accounting have traditionally based on Feng Shui or Confucian values and practices.

Nobes claimed that the classification variables have to be determined among the most powerfully differentiating factors which is related to measure the national accounting characteristics. For Chinese case, Hofstede’s cultural model and Gray’s societal values are the differentiating environmental factors. Also political and economical factors are included by the cultural factors for Chinese accounting practices.

For the last century, Accounting in China is deeply rooted in rules of Maoist ideology. The protection of socialist assets is within Accounting Law. Institutional entities are shaped by this collective aim. Accountants are responsible for both state government and enterprise managers. But the accounting was almost exposed to corrupt in Mao’s Era. Mao obstructed Accounting education to defend the communist regime from capitalist politics.

Also political and economical factors are inspected together with the cultural factors for the determination of Chinese accounting characteristics. For example, Chinese comply with the rules, because Confucian doctrine said that confidence and certainty are the most important elements of life. In addition, long-term means success; then culture is the dominant character. Political theory still remains a core subject of Chinese life style and affects on economical behave, state government habits, accounting practices. But the cultural influence dominate both of them. Because of the persistence of social values, Chinese implementation provides that the development of a western accounting system carry on modern business transactions with Chinese characteristic. Weber’s model gave the reasons of Chinese stagnation. But the cosmos of the inseperable Yin-Yang have survived cultural extent and life style on balancing organizational operations like profit and lost measurement.
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