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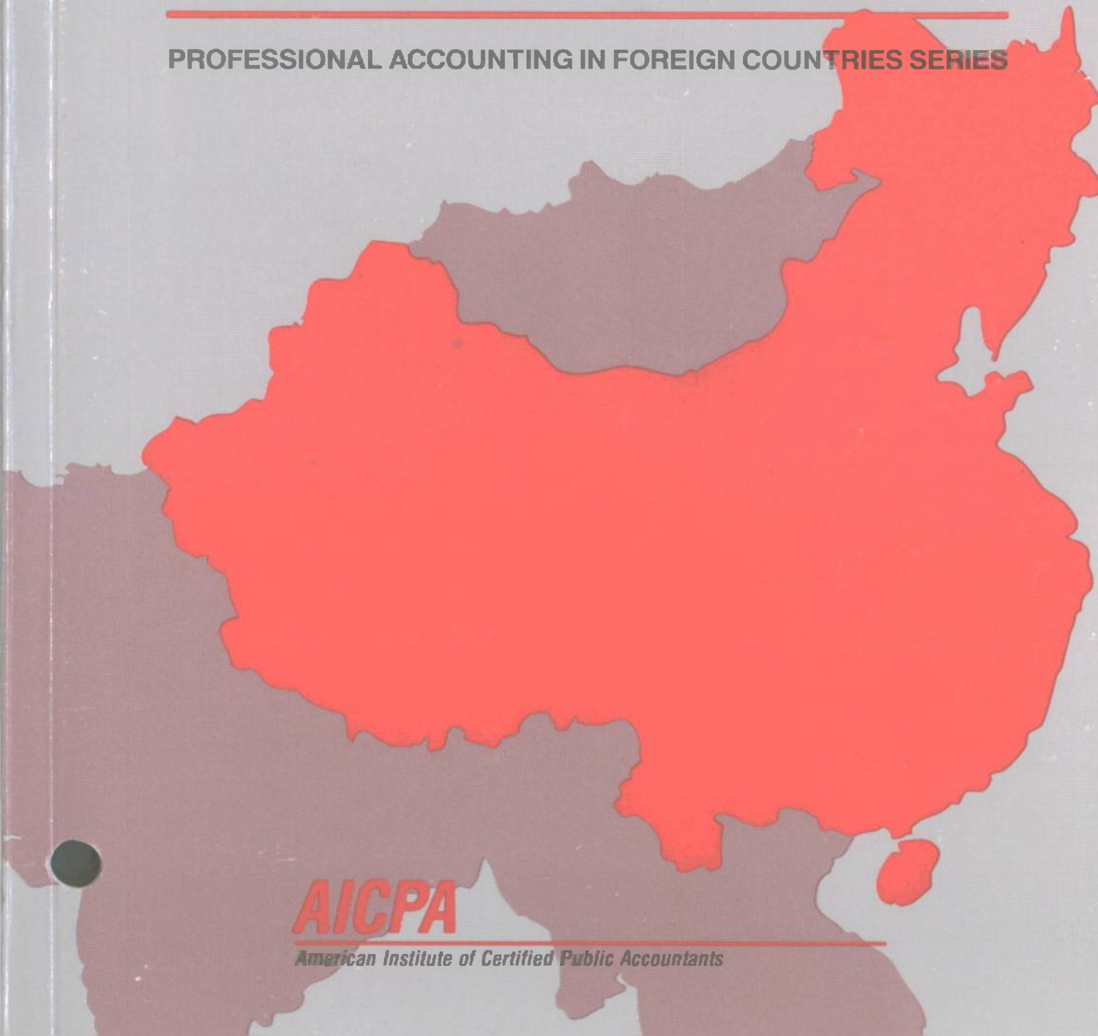
The Accounting Profession in China

PROFESSIONAL ACCOUNTING IN FOREIGN COUNTRIES SERIES



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American Institute of Certified Public Accountants

The Accounting Profession in China
PROFESSIONAL ACCOUNTING IN FOREIGN COUNTRIES SERIES
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The Accounting Profession in China

PROFESSIONAL ACCOUNTING IN FOREIGN COUNTRIES SERIES

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Preface

This booklet is one of a series on professional accounting in foreign countries. The material is current as of February 1994. Changes after this date in the standards of either the United States or China may alter the comparisons and references detailed in this publication.

Included are descriptions of the accounting profession, auditing standards, and accounting principles in China. The booklet also presents brief descriptions of the various forms of business organizations, taxes, and requirements for stock exchange listings and securities offerings. Checklists comparing Chinese auditing standards and accounting principles with those generally accepted in the United States are included as appendixes to the text.

This booklet is not intended to be a comprehensive discussion of auditing standards and accounting principles in China but is designed instead to focus primarily on differences from those of the United States.

John F. Hudson
Vice President—Technical
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The Accounting Profession

REQUIREMENTS FOR ENTRY INTO THE PROFESSION

1. Until recently, accounting practices in China were highly regulated by government authority. Dramatic changes have taken place in Chinese accounting as a result of the progress of capitalist-style economic reforms since the late 1970s. In keeping pace with the emergence of more diversified economic and business patterns, public accounting has been introduced and the accounting profession has emerged. Although the profession is still in its early stages, it is playing an increasingly significant role in the development of the Chinese economy.

Domestic Functions and Licensing Requirements

2. The term *accountant* is used broadly in China. It has traditionally referred to the accounting personnel in industry and government. However, the new designation *certified public accountant (Chinese CPA)* has been offered since the early 1980s to those accountants who practice public accounting.

3. The professional accounting bodies include the Chinese Society of Accountants (CSA), the Chinese Institute of Certified Public Accountants (CICPA), and the Chinese Association of Certified Auditors (CACA). The CSA, comprising accountants in industry, academics, and government officials in charge of accounting affairs, is the largest national accounting body. It is involved in accounting

research and formulation of practical accounting recommendations to supplement the statutory accounting regulations.

4. The CICPA, organized in 1986, is the national professional association of practitioners in public accounting. It consists of Chinese CPAs who are registered with the State Ministry of Finance or its bureaus at the provincial level. Under the Certified Public Accountants Act of the People's Republic of China, 1993 (the CPA Act), only Chinese citizens who meet the requirements of professional knowledge, skill, experience, and ethical standards, and obtain government approval, can be granted the professional designation of certified public accountant. The CICPA is an institutional member of the CSA, with its own sub-institutes operating at the provincial level across the country. The CICPA is responsible for establishing auditing guidelines (practical standards) and ethical rules for public practitioners. The CICPA can be reached at the following address:

The Chinese Institute of Certified Public Accountants
Ministry of Finance
Sanlihe
Beijing 100820

5. As authorized by the CPA Act and other business legislation and regulations, CPAs offer a wide range of services to the public, such as verification of capital investment, asset appraisal, the audit of financial statements, tax services, design of accounting systems, and training of accounting personnel. In addition, a CPA can act as a business consultant, registrar of a corporation, liquidator, or receiver or trustee of a company in bankruptcy.

6. Certified auditors, who are members of the CACA and are under the jurisdiction of the Chinese State Auditing Administration (CSAA), also provide public accounting services. The certified auditors can offer public accounting services only to state-owned or state-funded entities, and the scope of their services is relatively narrow compared to that of CPAs.

Foreign Reciprocity

7. According to the CPA Act and other statutory requirements, only Chinese CPAs are eligible to perform public accounting

functions. This applies especially to Chinese public corporations listed on the stock exchanges and to business entities with foreign investments.

8. There is no provision regarding foreign reciprocity in the CPA Act. Foreign CPA firms are permitted to offer public services to corporations with foreign investment. Foreign CPAs are allowed to provide consultative services and technical assistance to Chinese CPAs. They are also allowed to audit and provide certification of overseas transactions of Chinese corporations on a subcontract basis.

9. Cooperation between foreign CPAs and Chinese CPAs is increasing. All the major international accounting firms have established representative offices or branches in the major cities. Foreign CPAs and Chinese CPAs have been allowed to form joint ventures or partnerships with each other since the early 1990s.

ROLES AND RESPONSIBILITIES OF STANDARD-SETTING BODIES

Professional Standards Promulgated by Each Body

10. Most business regulations or professional standards are promulgated by government authorities. The national accounting regulations and standards are established by the State Ministry of Finance. However, the CICPA has been delegated the authority for developing professional standards and rules for public accounting practices. In addition to issuing auditing guidelines and standards for public practice, the CICPA has formulated ethical rules relating to public practitioners.

11. Although the CSA has no authority in setting accounting standards or regulations, it has been active in forming Chinese accounting standards. The CSA established a study group of accounting principles and standards in 1987 with a mandate to develop a theoretical framework of standard-setting for the government regulatory authority. On a consulting level, the CSA has been involved with the formulation of the nationwide accounting regulations and standards that went into effect in 1993, and has proposed

a series of nonbinding accounting recommendations as a supplement to the national accounting regulations and standards.

12. The professional standards or practical guidelines for certified auditors are promulgated by the CSAA with input from the CACA.

Ethics Requirements

13. Most of the internationally accepted ethical standards for public practice are adopted or followed in China. Those requirements are incorporated in the CPA Act and in *Ethical Rules on Professional Conduct of Chinese Certified Public Accountants* issued by the CICPA. The ethical rules cover a wide range of matters such as the basic principles regarding personal integrity, professional competence, and ethical behavior in the engagement of public practice. It also addresses the responsibility of a public practitioner towards his or her clients and peers. The major ethical requirements for public practitioners are as follows:

a. Observance of laws, government regulations, business contracts, bylaws, and agreements
b. Independence and impartiality
c. Objectivity and truthfulness
d. Confidentiality

PROFESSIONAL PUBLIC ACCOUNTING ORGANIZATIONS

14. CPAs under the CICPA have significant influence in the practice of public accounting. According to the CPA Act, Chinese CPAs can provide public services only through a partnership, known as the accounting firm, with government approval.

15. However, members of the CACA may also offer public accounting services in China. Auditing firms are under the jurisdiction of the CSAA. Although there is no provision in the CPA Act that authorizes the CSAA or certified auditors to engage in public accounting, there is no prohibition either. Because of a complicated government jurisdictional structure in China, some members of the

CACA are participating in public accounting practices in direct competition with CPA firms.[1]

16. Efforts to reconcile the two organizations involved in public accounting have begun. The main goal of these efforts is to maintain a single professional designation of *public practitioner.*

Requirements for Membership

17. According to the CPA Act, a person may become a CPA if he or she meets these requirements:

a. Chinese citizenship
b. College or equivalent education
c. A minimum of two years of working experience in auditing
d. Successfully passing the national professional examinations or evaluations

18. Certain persons can obtain a waiver of the professional examinations. Those accountants with senior accounting titles, associate professors in accounting at colleges or universities, or those with lengthy work experience in accounting (over twenty years) are exempt from the professional examinations. They may receive their CPA designations through evaluation by the CICPA or the government authority, in addition to meeting other qualification requirements.

19. Under the CPA Act, a person who fulfills all the qualification requirements should register with the State Ministry of Finance or the Bureau of Finance at the provincial level. The CPA certificate is issued by the State Ministry of Finance. The certificate must be returned to the government authority if a CPA resigns from an accounting firm and reregistration is needed if he or she joins another accounting firm. Staff of government departments are not permitted to apply for a Chinese CPA certificate.

20. Membership and qualification for certified auditors are administered by the CACA and the CSAA. Although in many aspects

[1]However, certified auditors are not able to provide the full range of public accounting services. For instance, only CPA firms are allowed to provide certification of capital and financial statement audits for business entities with foreign investment and for publicly listed corporations.

the requirements are similar to those of CPAs, they are relatively less strict. No nationwide professional examinations for certified auditors are required.

Rights of Membership

21. Membership in the CSA is available to any accounting practitioner, academic, or administrator. Membership in the CICPA is restricted to Chinese CPAs and is a precondition for the practice of public accounting. Such membership is lost when a member cannot maintain a minimum amount of practice time after registration or when he or she resigns from an accounting or auditing firm.

Number of Members

22. At the end of 1993 there were about 700 CPA firms in China, and CICPA membership exceeded 10,000. There were about 6,000 certified auditors engaged in public practice.

CPE Requirements

23. To maintain the high standards of competence required by the profession, each practicing member must devote a certain amount of time each year to improving his or her own training, as well as that of their subordinates.

24. According to the CICPA, a CPA is required to devote a minimum of two weeks annually, or two cumulative months over a period of three consecutive years, to continuing professional education or training.

25. The CICPA is committed to provide planning, consultation, staffing, materials, and supervision of continuing professional education (CPE) for its members.

2

Auditing Requirements

STATUTORY AUDITING AND REPORTING REQUIREMENTS

Purpose of the Statutory Audit

26. According to the *Auditing Act of the People's Republic of China* of 1982, the *Law of the People's Republic of China on Business Enterprises With Foreign Investments* of 1987, and the *Company Act of People's Republic of China* of 1993, all business entities administered by or registered with government authorities are obliged to have financial audits. The roles of the statutory auditor, as defined by the related legislation, are as follows.

Verification of Compliance With Statutory Requirements

27. The statutory auditor has an obligation to determine if a business entity has complied with the state's business laws, legislation, and related government regulations regarding corporate financing and accounting, and to report to the government finance department and industrial administration. The statutory auditor must verify that an entity has not violated the relevant laws, regulations, and business contracts; has established its accounting and reporting system in conformity with the statutory requirements; and has provided complete information to the specified government authorities on a timely basis.

Certification of the Truthfulness of Accounting Information

28. According to legal requirements, the statutory auditor must examine an entity's books of accounts and certify the truthfulness

and completeness of the financial statements and required supplementary information submitted to government authorities, and to the investors or shareholders if applicable. The certification must ensure not only the accuracy of the accounting data but also an adequate presentation of the financial statement items specified by statutory requirements.

Verification of Taxable Income

29. Another purpose of statutory audits is to facilitate correct and prompt tax collection by the taxation authorities. The auditor must verify the profit or loss of an entity during the operating period. In addition, the revenue and expense accounts should be examined to ensure that there is no violation of the statutory rules on product costing and no misappropriation of working capital.

Verification of Paid-in Capital

30. The auditor must verify the valuation of assets and paid-in capital accounts for most of the corporate-type entities for the purpose of business registration (also for business dissolution). This enables the auditor to certify the authenticity, validity, completeness, and timeliness of the paid-in capital committed by the parties involved in an entity.

Entities Required to Be Audited

31. Business entities, except for small personal businesses, are subject to statutory audit, although the audit requirements vary for different businesses. The entities that must be audited include the following:

- State-owned enterprises and state-funded entities
- Limited-liability companies
- Stock companies
- Businesses with both Chinese and foreign investments

Appointment and Qualifications of Auditors

32. The CSA usually assigns the statutory auditor to perform financial audits for all state-owned or state-funded entities. Other types of business entities must appoint an auditor or auditors to

perform assessment and certification of the paid-in capital and the financial statements. This is usually done by the board of directors.

33. The first auditor or auditors should be appointed during the process of incorporation. All capital contributed to public and private companies as well as to entities with foreign investments must be certified for registration and licensing purposes. Annual corporate financial statements must be audited by the auditor or auditors appointed by the board of directors.

34. The statutes stipulate that only the public accountants registered and approved by the Chinese authority can serve as the auditor for public corporations and business entities with Chinese and foreign capital. Chinese CPAs offer public services through partnerships that must consist of at least two full-time CPAs registered with the Chinese authorities. An individual CPA or certified auditor is never appointed. Usually, the government authorities of taxation and industrial administration are notified of the appointment of an auditor.

35. No legal provision exists for termination or removal of the incumbent auditor or auditors. Usually, the board of directors has discretion in the appointment or removal of the auditor, provided that the government administrative and taxation authorities have been informed of the change. However, according to the CICPA's *Ethical Code of Professional Conduct for CPAs*, the prospective new auditor must contact the original auditor before officially accepting the appointment.

Auditing and Reporting Responsibilities

36. It is an auditor's responsibility to report whether the financial statements presented by the corporation's management are adequately prepared in accordance with the statutory requirements. The auditor's report must indicate if the statements have truthfully represented the financial position, profit or loss, and change in financial position of the entity. Auditors of public corporations or business entities with foreign capital are responsible for rendering certificates of paid-in capital or asset valuations.

37. Corporate management is obliged to maintain complete books and records and to prepare financial statements in a timely

manner. An auditor is obliged to report to senior corporate management or the appropriate government department any fraud, misappropriation, or serious violation of business legislation or regulations discovered during the audit.

38. An auditor also is responsible for providing, in the auditors report, specific information about any major departures from required accounting practices or rules. If an auditor believes that the departure is inappropriate and will have a negative impact on the truthful and adequate presentation of the financial statements, he or she, in addition to referring to the information in the notes and disclosing it in the report, should express a qualified opinion, or an adverse opinion if the departure is substantial. The quantified financial effect of the departure should be disclosed if its determination is practicable.

Filing of Reports

39. For state-owned or state-funded business entities, the audit report and audited financial statements are required to be filed with the taxation authority to support the tax returns filed by the entity. They must also be filed with the government authorities (Ministry of Finance or specified industrial ministries) under which the company is administered.

40. For publicly listed corporations, the financial statements and audit reports should be filed with the listing stock exchanges and the state's securities administrative authorities, and they should be available for inspection by investors upon request.

41. For business entities with foreign investments, the financial statements and audit report should be submitted to the Ministry of Foreign Trades and Economic Cooperation (or its branches at the provincial level). A copy of the financial statements and audit report should also be filed with the local Bureau of the Industry and Commerce Administration where the entity was originally registered or licensed.

42. Financial statements are usually accompanied by the signatures of the executive directors (or general manager), regarding the management analysis of financial position and other supplementary

information specified by government authorities or the stock exchanges. The audit report should include the auditor's signature and the official seal of the accounting firm involved.

SUMMARY OF SIGNIFICANT AUDITING STANDARDS AND COMPARISON WITH U.S. GENERALLY ACCEPTED AUDITING STANDARDS (GAAS)

Standards Issued

43. The CICPA has issued several guidelines or standards governing public practice. They prescribe the basic principles and practices that public practitioners are expected to follow in conducting an audit. A list of the CICPA's publications of auditing standards and guidelines are presented in appendix A.

General Standards

44. The general principles included in the CICPA's auditing standards and guidelines cover a variety of aspects of public practice. They specify that—

a. The scope of the engagement is determined by the appropriate laws.

b. Company management is responsible for preparing the financial statements, supervising the efficiency of the various departments of the company, and monitoring staff activity.

c. Professional judgment is an essential element of the auditor's work.

d. The statutory auditor can delegate some of his or her work to assistants but retains complete responsibility for the work delegated.

Code of Conduct

45. The CICPA issued the *Ethical Rules of Professional Conduct for CPAs* in 1992, which specifies the principles for professional behavior such as competence, independence, objectivity, audit planning, supervision and evaluation, confidentiality, disclosure of management misconduct, and acceptance and retention of engagements.

46. A public practitioner is prohibited from aggressively advertising for clients or degrading other practitioners, and is not allowed to accept business engagements based on discounted fees or shared commissions.

47. The penalties for a violation of the ethical requirements range from a warning from the CICPA or the appropriate government authorities to revocation of the member's professional designation and dissolution of the accounting firm involved.

48. Although no explicit auditing guideline on due care in the performance of audit work exists, the need for due care is emphasized in practice. An auditor is liable for any audit error or negligence in his or her work.

Standards of Fieldwork

49. The CICPA has developed several specific guidelines on the fieldwork of an audit. The basic requirements are similar to those in the United States.

Planning the Engagement

50. An auditor should obtain an overall knowledge of the company to be audited. The purpose of this approach is to identify the risks that could have a significant impact on the financial statements and to enable the auditor to—

a. Determine the nature and scope of the audit work, after considering materiality.
b. Perform the engagement in an efficient and timely manner.

Evaluation of Internal Control

51. An auditor should evaluate a client's internal control system to identify the controls he or she intends to rely on and the risks of error in processing accounting information. The auditor should then develop an appropriate audit program.

Obtaining Evidence

52. In the course of the engagement, an auditor should obtain sufficient and relevant evidence to provide a reasonable basis for an

opinion on the financial statements. In this respect, he or she can apply different audit procedures, such as transaction tests, inventory observation, direct confirmation, field inspection, document authentication, and analytical review.

Delegating and Supervising

53. An auditor may delegate much of the detailed work to assistants. However, he or she should supervise and examine the work delegated to ensure that it has been performed as intended and to determine if it supports the audit opinion. The auditor remains fully responsible for the results of the audit work.

Review of Financial Statements

54. An auditor should conduct a thorough review of the financial statements, including verification of the opening balances in the balance sheet and the comparative data in the income statement. The review, in conjunction with the conclusions drawn from other evidence obtained, should give the auditor a reasonable basis to form an opinion on the financial statements.

Field Documentation

55. An auditor should prepare audit work papers to document the work carried out and to support the audit opinion. The work papers should organize and control the engagement and provide evidence that the audit includes all tests and procedures that were deemed necessary. The audit papers are the sole property of the accounting firm and should be maintained for a reasonably long period.

Relying on the Work of an Internal Auditor

56. To determine whether to rely on the work carried out by internal auditors, an auditor should—

a. Evaluate the internal audit function within the company.

b. Make appropriate tests of the internal auditor's work and determine whether or not the conclusions reached are in compliance with the objectives of the audit engagement.

c. Maintain sufficient documentation of work done by the internal auditors.

Relying on Work Performed by Specialists

57. An auditor may utilize specialists in the engagement. He or she should evaluate the qualifications and competence of the specialists as well as the objectivity, efficiency, and reliability of their work.

Cooperation With Other Auditors

58. An auditor may contract out part of the audit work to other domestic or foreign auditors if client transactions occurred in other geographical locations. He or she should communicate the nature of the engagement and the objectives of the audit work to the other auditors involved. The work done by other auditors should be reviewed before the auditor decides to incorporate it into the opinion.

Standards of Reporting

59. Under the *Guidelines for Auditing and Examination Reporting*, an auditor should provide an audit report after completing the examination and evaluation of all audit evidence.

Standard Form of Report

60. The audit report should express explicitly the auditor's opinion in one of the four short-form formats: unqualified opinion, qualified opinion, adverse opinion, or disclaimer opinion. The auditor should state whether or not the client's financial statements—

a. Complied with the relevant statutory requirements.
b. Reflected adequately[2] the financial position at year-end, the operating results, and the changes in financial position during the year.
c. Were consistent with the prior period in accounting treatment and financial statement presentation.

[2]*Reflect adequately* is standardized terminology in Chinese audit reports. According to the definition of the CICPA's reporting guidelines, it refers to the client's accounting procedures being in conformity with the related statutory requirements and the financial statements being complete in their contents, expressed clearly, and free of material omission and misclassification.

61. The audit report should include a scope paragraph and an opinion paragraph. The report should be reviewed and signed by the chief accountant (partner-in-charge) of the accounting firm. An example of the standard form of unqualified auditor opinion is illustrated in appendix C.

62. The CICPA has also stipulated specific guidelines on when to use qualified, adverse, or disclaimer opinions in an audit report. An uncertainty that is considered material but is not fundamental requires a qualified opinion with a "subject to" provision. If the uncertainty about the financial statements or the restriction on the audit scope is so great as to render them, as a whole, meaningless, a disclaimer of opinion should be issued. If the financial statements severely violate the statutory requirements, the auditor should issue an adverse opinion.

Dating of Audit Report

63. The audit report should be dated when the fieldwork is completed. An auditor should note any events or transactions that occurred before the issuance of the audit report if they have a significant impact on the audited financial statements.

Supplementary Information

64. Supplemental information is required to accompany the audit report, which should include explanation of major adjustments of accounting records or financial statement items, elaboration of significant issues relating to the audit report, and material requested by the client.

65. The auditor may issue a long-form audit report if it is requested by the client. The format and degree of detail is based on the engagement contract or the clients actual conditions. The supplementary information may include—

- Detailed analysis of significant items, such as product-costing, expenses, sales, profit, and allocation of profit.
- Comparison with the prior period and explanation of major changes.
- Schedules of significant balance-sheet items, such as account receivables, inventories, or account payables.

- Elaboration of the audit procedures for significant financial statement items.

Management Recommendations

66. Under the CICPA's auditing guidelines, an auditor is responsible for evaluating a client's accounting system and other internal controls during the examination, for consulting with senior management about the potential deficiencies or weaknesses of the internal controls, and for making recommendations for improvement either verbally or in writing.

3

Accounting Principles and Practices

SOURCES OF ACCOUNTING PRINCIPLES

67. Accounting principles are set forth in *Accounting Standards for Business Enterprises (Accounting Standards)*, *General Standards for Business Financing*, and a series of related industrial accounting regulations formulated by the State Ministry of Finance (see appendix B). For the most part, these are consistent with the accounting practices in the United States. Several more specific accounting standards projects are under study. The Accounting Law, the Corporate Act, the Law on Business Enterprises With Foreign Investment, and the Regulation on Securities Issuance and Trading set forth the minimum statutory requirements for financial accounting and reporting. They also endorse the legal status of both the *Accounting Standards* and the industry-specific regulations issued by the State Ministry of Finance.

FORM AND CONTENT OF FINANCIAL STATEMENTS

Presentation of Statements

68. The annual financial statements must be sufficiently detailed to satisfy the requirements for truthful and adequate presentation. They must be prepared in Chinese and reported in Chinese Renminbi notes (RMB ¥). Data from the prior period should be presented in a parallel column in financial statements (a set of illustrative financial statements is presented in appendix C).

69. The executive directors (or general manager) of a company are required by the statutes to prepare, in every calendar year, a management's analysis of financial position (directors' report). It must be submitted, along with the audited financial statements, to the State Ministry of Finance (or the provincial bureaus) and other government authorities. Publicly listed corporations must also provide additional copies of those reports to the investors (shareholders) for their approval at the annual general meeting. The directors are also required to file these documents, together with the annual tax return and audited financial statements, with the taxation authority.

70. The annual report should contain information regarding a company's registered office, debenture holders, outstanding shares, debentures, and past and current directors of the board.

71. The filing of the annual report to the stock exchanges should be made within three months after the end of the fiscal year. Semi-annual interim financial statements should be submitted within forty-five days after the end of the first six months of the fiscal year. Private companies are exempt from such filing.

72. The management analysis of the financial position, the audited financial statements, and the interim financial statements must be approved by the board of directors. They must be signed by the executive directors (or general manager) on behalf of the board. The official seal of the company must also be attached.

73. According to the *General Standards for Business Financing* (article 42), a management analysis of the financial position should specify the following:

a. Production and operation of the business
b. Realization and allocation of operating profits (losses)
c. Changes in, and turnover of, the operating funds (working capital)
d. Taxes payable and payments made
e. Changes in physical assets and properties
f. Events that have significant impact on the financial position in the current and future periods
g. Significant post-balance-sheet events
h. Other events or transactions as deemed necessary

Types of Statements Prepared

74. Under current statutes, a company's financial statements should contain a balance sheet, a statement of profit and loss (and a statement of profit allocation), a statement of changes in financial position (or a cash flow statement), and accompanying notes or schedules.

75. If a company has subsidiaries, it is required to present the group accounts of the company at the end of each fiscal year. *Accounting Standards* and other accounting regulations require that consolidated financial statements be prepared and filed if a company maintains over 50 percent of the equity or has substantial control of a subsidiary.

76. When a subsidiary has not been included in the consolidated financial statements, the fact and the reason should be disclosed. In addition, when a subsidiary is omitted from the consolidation on the basis of dissimilar activities, the group reports should include the separate financial statements of the subsidiary and provide information regarding the following:

a. Details of the holding company's interest
b. The nature of any related-party transactions
c. Shares and amounts due to or from the subsidiary

77. When a subsidiary is excluded from the consolidation on the basis of lack of effective control, the statutory accounting standards recommend that it be accounted for in the group accounts under the equity method.

SUMMARY OF SIGNIFICANT ACCOUNTING PRINCIPLES AND COMPARISON WITH U.S. GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (GAAP)

78. The fundamental accounting concepts documented in *Accounting Standards* include going concern, actual (historical) cost, accrual basis, truthfulness or authenticity, consistency, comparability, realization, matching, prudence, and timeliness. A brief

discussion of the significant accounting principles prevailing in China is presented in the following sections.

Valuation Principles

79. Financial statements are based on the actual (historical) cost convention. Market values are generally prohibited in valuation. Revaluation of property, plant, and equipment may be permitted if they result from the government's price adjustments or are due to business restructuring (such as converting a state-owned enterprise into a corporation). They must be approved by the appropriate government authority. Replacement cost or current market value should be applied in the revaluation. The surplus or deficit arising in revaluation must be transferred to an equity account (that is, statutory reserve on asset revaluation) and cannot be used to absorb operating losses or be distributed as a dividend.

Revenue and Expense Recognition

80. Revenues are recognized when earned and realization is reasonably assured. Expenses are recognized when incurred as a reasonable matching to the revenues being generated. The accrual basis is normally utilized.

Inventories

81. Inventories are categorized as raw materials, small tools and consumables of low value, work in process, and semifinished and finished goods. Inventories are valued and reported at acquisition cost. No market valuation is allowed unless the state adjusts the prices for inventories.

82. A variety of accounting methods for the flow of inventories is permitted by *Accounting Standards* and related regulations. Business entities may choose either FIFO, weighted average, moving average, individual valuation, or LIFO as deemed appropriate for their business conditions.

83. Standard (projected) costing is allowed for the acquisition or manufacture and consumption of inventories to simplify record keeping. The variance between standard and actual costs must be

reconciled, and only actual costs are reported at the end of each accounting period.

Fixed Assets

84. Fixed assets must be valued at actual (historical) acquisition costs or manufacture costs for self-constructed assets. Loan interest and other expenses incurred before the completion or operation of the fixed assets must be capitalized. Donated assets should be recorded on the basis of current market value.

85. All fixed assets must be depreciated by systematic methods based on the life, total output, or capacity of the assets. The State Ministry of Finance specifies the depreciation periods, rates, and specific methods for major categories of assets from which business entities in various industries can choose.

86. According to *Accounting Standards* of 1992, accelerated depreciation may be applied in certain circumstances but advance approval by the government's finance or taxation authority is needed.

87. The difference between the proceeds from disposal of fixed assets and their book value is recognized in income in the year of disposal.

Intangibles and Goodwill

88. Externally generated intangible assets such as industrial knowledge, trademarks, and copyrights are recorded in the statements. According to the statutory accounting requirements, intangibles are valued on the basis of acquisition costs and are reported separately on the balance sheet.

89. In general, intangible assets must be amortized over the amortization periods determined by the government finance department. The amortization period should not be less than ten years if no regulated amortization period is available.

90. Goodwill is included in intangible assets, but no specific statutory accounting treatment for goodwill currently exists, except that the goodwill, like other intangible assets, must be amortized on the basis of its estimated useful life. If the useful life cannot be

reasonably determined, the amortization period should not be less than ten years.

Related-Party Disclosure

91. Accounting standards on related-party disclosure have not been developed. The statutory provisions on information disclosure for securities require that publicly listed companies must disclose information about related-party transactions.

Segment Reporting

92. No accounting standards or regulations regarding the disclosure of segment information currently exist.

Effects of Inflation

93. No statutory requirements currently exist for the disclosure of the effect of inflation.

Receivables

94. *Accounting Standards* of 1992 permits the recognition of a provision for doubtful receivables. It should be reported as a contra account against the receivables on the balance sheet. If the receivables become uncollectible, the provision should be charged first, with any remaining balance charged to current income.

Long-Term Investments

95. Long-term investments in other entities can be accounted for using either the cost or the equity method. Investments in corporate bonds are recorded on the basis of the actual amount invested. Interest should be recorded separately. The premium or discount on bonds purchased should be amortized before maturity. Interest income and gains or losses from the disposal of investments in corporate bonds are included in current income.

96. Corporate bonds should be valued at par. Any discount or premium from bond issuance should be accounted for separately and amortized over the life of the bond.

Liabilities

97. Liabilities are classified in two broad categories: current and long term. Current liabilities are defined as obligations that must be settled within one fiscal year. Otherwise, the liability is deemed long

term. In the balance sheet, both current and long-term liabilities should be reported separately under various subgroups, based on the different terms or nature of the liabilities.

Leases

98. There is no accounting standard or regulation concerning leases. *Accounting Standards* of 1992 states that leased fixed assets should be accounted for in a manner similar to self-owned assets and that an explanatory note should be provided.

Research and Development Costs

99. Statutory guidelines or standards for the accounting of research and development costs are not currently available. In practice, they are treated in a variety of ways, depending on the nature of the research and development. It is common for the research costs to be charged to current income, whereas development costs that enhance the productive capacity of the related physical assets or properties are capitalized.

Pension Costs

100. Pension accounting is not an issue since there are no private pension plans currently in existence. However, foreign-funded entities can charge pension expense to current income on an accrual basis. No pension liability is recognized.

Foreign Currency Translation

101. Under the current statutes, business entities should use Chinese currency as the recording currency. Foreign currency may be chosen as the recording currency if it is the functional currency for a business entity's operation.

102. Transactions that occur during the year and are denominated in foreign currencies should be translated into Chinese currency based on the official exchange rate on the transaction date. Closing balances of all foreign currency items should be translated into Chinese currency utilizing the exchange rate on the balance-sheet date. Exchange gains and losses resulting from translation should be included in current income.

103. Exchange gains and losses relating to the financing of capital construction projects or the development of fixed or intangible assets should be capitalized.

Deferred Taxes

104. Income taxes are accounted for on an accrual basis. Generally, there is no difference between income (or loss) for tax and accounting purposes. No specific accounting regulation or standard exists for deferred taxes. Deferral and amortization is allowed if a significant difference arises between taxable and accounting income due to a change in accounting regulations.

Long-Term Contracts

105. Accounting for long-term contracts is based on the cost principle. No losses can be recognized before their occurrence. Profits may be accounted for using either the percentage-of-completion method or the completed-contract method. In practice, the percentage-of-completion method is more frequently used.

Business Combination and Consolidated Financial Statements

106. The pooling-of-interests method is not allowed for mergers. Consolidated financial statements (in addition to the entity's financial statements) must be provided if a company holds the majority interest in another entity. Exemptions exist when subsidiaries are involved in different businesses from the parent company, and approval from the stock exchanges is generally required. The equity method would be used for subsidiaries that are excluded from the consolidated financial statements.

4

Business Environment

FORMS OF BUSINESS ORGANIZATION

107. Diverse ownerships of business exist (for example, state ownership, collective ownership, and private ownership). The forms of business organization include state-owned enterprises, corporations, partnerships or joint ventures with Chinese and foreign capital, and sole proprietorships.

108. Most business entities were previously owned by the state and were administered by the industrial administrative departments under central or local authorities. The government appointed management provided the majority portion of capital for the businesses and collected profits (or covered losses) directly. Recently, as part of the process of economic restructuring in the country, many state-owned enterprises have been converted into corporations.

Entities With Corporate Attributes

109. In China, either a limited-liability company or a stock company can be incorporated.

110. Under the Company Act of the People's Republic of China of 1993 (the Company Act), in a limited-liability company the liability of a member is limited to the amount the member has contributed. Approval by government authorities is needed for establishing a limited-liability company. A minimum capital of RMB ¥300,000–500,000 (depending on the nature of the business and its operation) is required for the registration of a limited-liability company.

111. A stock company must have more than five initial incorporators or sponsors (over half must have residence in China). The application must be approved by the state securities administrative department under authorization by the State Council. A minimum authorized capital of RMB ¥10 million is required for the registration of a stock company.

112. Statutes prohibit the limited-liability company from offering shares for public subscription. A stock company is a public company, but it is not necessarily listed on the stock exchanges. A limited-liability company or a stock company must identify its business nature explicitly in the company's name. A stock company is subject to stricter requirements than a limited-liability company.

113. A corporation must hold regular general meetings of shareholders. Ordinary meetings must be held at least once a calendar year. Extraordinary meetings can be held whenever there is any significant event or when recommended by a quarter of the shareholders or one-third of the members of the board of directors. The following decisions can be made only by resolution of a general meeting of shareholders:

a. Amendment of corporation charter
b. Review and approval of reports by the board of directors
c. Changes in the authorized capital
d. Issuance of corporate bonds
e. Approval of annual budgets and financial statements and allocation of profits or losses
f. Election of directors and supervisors and determination of their compensation
g. Approval of the company's merger, division, dissolution, or liquidation

114. Although the liability of a member of both a limited-liability company and a stock company is limited, a director will be penalized if he or she fails to carry out his or her obligations as stated in related statutes. The duties include keeping proper books and records according to statutory requirements, presenting audited financial statements to the members at the general meeting, and filing annual reports and tax returns with government administrative

authorities. A director faces unlimited liability when a company has traded fraudulently with his or her express knowledge.

115. The Company Act requires that a public company set up two types of surplus reserve accounts: statutory reserves and general reserves. Ten percent of after-tax profits must be set aside as the statutory capital reserve, until the balance of the surplus reserve has reached 50 percent of the total registered capital. The surplus reserve may be used to cover operating losses, increase share capital, or declare a dividend. These actions may be taken only if the remaining balance of the surplus reserve exceeds 25 percent of the total registered capital, and they must be approved by special resolution of the general meeting of the shareholders. In addition, another five to ten percent of profits should be appropriated as statutory reserve for employee welfare projects.

Branches of a Foreign Company

116. In addition to forming joint ventures with Chinese partners, foreign companies have been allowed to establish fully owned subsidiaries in China since the early 1980s. They must register these subsidiaries with the Chinese authorities and comply with the Chinese laws and regulations governing business activities.

117. Foreign companies wishing to establish a subsidiary in China must file an application with the Ministry of Foreign Trade and Economic Cooperation. The following documents should be submitted with the application:

a. A copy of the charter of incorporation, the memorandum and articles of association or any other instrument constituting or defining the constitution of the company, and a copy of the registration certificate in its home country

b. Names and addresses of the company's authorized representatives in China (or members of the board of directors) and the address of the principal place of business in China

c. A written agreement from the local government where the company intends to locate the subsidiary

d. A copy of the legal and credit certificate of the foreign company

118. The application letter and incorporation charter should be written in Chinese. Other documents may be in foreign languages with a Chinese translation. A minimum investment capital is RMB ¥30 million.

119. A subsidiary of a foreign company should register with the local Bureau of Industry and Commerce Administration for a business license. Within thirty days after receiving the approval certificate from the Ministry of Foreign Trade and Economic Cooperation, it must submit a declaration with the tax authority. The subsidiary should be a legal entity with its own books of accounts for business activities within Chinese territory. Annual financial statements, in the forms required by the related legislation and regulation, should be submitted to the government authorities. If the financial statements are prepared in foreign currency, a copy converted to Chinese currency should also be submitted.

120. According to the statutory requirements, a subsidiary of a foreign company can remit after-tax profits to its parent company.

Partnership Entities

121. Varied types of business partnerships exist in practice. Some are ventures by groups of individuals (also called collectively owned businesses); others are production associations among various state-owned enterprises; the remainder are joint ventures between Chinese and foreign investors.

122. Partnership entities must be registered and approved by the relevant government authorities. In general, partnerships among Chinese entities should register with the industrial administrative authorities and the Bureau of Industry and Commerce Administration. Partnerships between Chinese and foreign investors must be approved by the Ministry of Foreign Trade and Economic Cooperation and the local government. Business licenses must be obtained from the state Bureau of Industry and Commerce Administration. There is no legal restriction on the proportion of equity holding of the partnership. Either a Chinese or foreign partner can serve as chairman of the board of directors.

123. Most partnerships are granted a limited life for the duration of specific projects. Renewal is permitted before the expiration of

the original contract. Application for renewal of the partnership should follow the same procedure as the original registration. Termination and liquidation of the partnership should be filed with the same government authorities who granted the original approval.

Other Forms of Business Organization—Sole Proprietorship

124. A sole proprietor is an individual engaged in a business or profession on his or her own. The owner may be either Chinese (individual business) or foreign (sole foreign business). As with any other form of business organization, a sole proprietor must apply to the government administrative authorities and register with the local Bureau of the Industry and Commerce Administration. The financial statements of a sole proprietor need not be publicly disclosed. The tax authority may, however, require an examination of the books. Banks or other financial institutions may also require an examination to grant loans or credits.

REQUIREMENTS FOR PUBLIC SALES OF SECURITIES AND FOR LISTING SECURITIES ON THE STOCK EXCHANGES

125. The requirements for public sales and listing of securities on the stock exchanges are primarily contained in the Company Act and the Regulations on Securities Issuance and Trading.

Registration Requirements for Public Sale

126. A public sale of securities must get approval from the China Securities Regulatory Commission and the related administrative department. A company must file an application with the Review and Approval Committee on Securities Issuance. To qualify, a company must demonstrate that—

a. It is a stock company approved by government administrative authorities.

b. Its operation is consistent with the state's industry policy and of sufficient interest to the public.

c. It is profitable and able to distribute dividends and that its conduct has included no significant violation of laws and is free of fraudulent accounting reports for the latest three years.

127. A prospectus of offering should be filed, specifying the purpose, type, volume, par value (if applicable) and prices of shares to be issued, and the offering and settlement date of issuance. According to statutory requirements, subscription by the offerer should not be less than 35 percent of the total shares to be issued and not less than RMB ¥30 million. The percentage of public offering may be reduced if the total amount of shares to be issued exceeds RMB ¥400 million, but it should not be less than 10 percent of the total issuance. Subscription by the company's employees should not exceed 10 percent of the total shares offered to the public.

128. The following documents are required to be attached to the prospectus:

a. The charter of corporation and incorporation filing
b. The financial statements for at least the latest three years and the audit report signed by two or more certified public accountants under the official seal of the accounting firm
c. A legal opinion on the issuance signed by two or more lawyers under the official seal of the law firm
d. The asset appraisal report by a recognized appraisal agent and the capital assessment certificate issued by a certified public accountant
e. The forecast of earnings for the next fiscal year
f. The names and addresses of the underwriters along with a copy of the underwriting agreement

129. According to the Regulation on Information Disclosures for Securities Issuance and Trading, the following should appear on the cover sheet of the prospectus:

> It is the offerer's obligation to ensure the authenticity, accuracy, and completeness of the prospectus. Any decision on issuance of the proposed shares by the government and related state securities administrative authorities does not represent a substantial judgement and guarantee for the value of the proposed shares or the resulting investor's return.

Requirements for Listing Securities on the Stock Exchanges

130. Public companies should apply for stock listing on the exchanges authorized. To qualify, the company should demonstrate that—

a. The total amount of the outstanding shares is at least RMB ¥50 million.

b. The company has been profitable in the latest three years (except for new corporations).

c. The total number of shareholders exceeds 1,000, and the equity held by the shareholders is at least 25 percent of the total shares outstanding.

131. The company should provide several documents to the stock exchanges, including the following:

- Application of Listing
- The latest prospectus of public offering and the approval of public issuance by the NSSC
- The financial statements for the latest three years
- The audit report and lawyer's opinion
- The forecast of earnings for the next fiscal year
- Recommendations from stock exchange members

132. After approval by the Listing Committee, the company should publish a notice of listing in the designated national newspapers and other media at least three business days before the first trading date. The content of the notice should include the approval of listing, the scheduled date of first trading, the availability of the prospectus, the status of share offering, and the number of shares outstanding.

133. Stock can be issued in registered or nonregistered form and at par value or a premium. No discount issuance is allowed. Issuance premiums should be treated as a capital reserve.

Filing of Annual Financial Reports and Other Significant Information

134. Publicly traded companies must submit semiannual interim and annual reports to the NSSC and stock exchanges. The interim report should contain the company's financial statements,

management analysis of financial position, changes of outstanding shares, pending significant lawsuits, and any significant information. Additional information to be disclosed in the annual report follows:

- Company's profile, major products, and industrial statistics
- List of land, mines, plants, and other properties owned
- Total number of shareholders and the names and shareholdings of any shareholders with over 5 percent of the total outstanding common shares
- Profile of the directors, supervisors, and senior managers, and their shareholding and compensation
- Chart of related parties
- Changes in outstanding debentures
- Financial summary of the latest three years (or since the incorporation)
- The latest two-year comparative financial statements audited by the CPAs. (Comparative consolidated financial statements should be included for a holding company.)

135. The interim and annual reports must be in conformity with the statutory accounting requirements issued by the State Ministry of Finance and the NSSC. A brief summary of the reports must be published in the designated national newspapers, and the reports must be available upon request.

136. Publicly traded companies should immediately notify the stock exchanges and the NSSC if major events occur that could have significant impact on the market price of the company's stock. They should also release this information to the public within ten business days. The company may withhold public release only if it has sufficient reason to believe that the release will severely hurt its interest and has obtained prior approval from the stock exchanges.

137. The NSSC or the stock exchanges may suspend a company's trading if one of the following events occur:

a. The total amount and structure of share capital do not meet the requirements.

b. The company has failed to disclose required information or has released fraudulent information.

c. There have been continuous operating losses, and the company is facing severe financial problems.

d. There has been a severe violation of the law.

SELECTED ECONOMIC DATA

138. Key demographic and social factors, based on 1992 Chinese census data, follow.

Area (in millions of square kilometers)	960
Population (in millions)	1,171.7
Annual population increase	11.6%
Life expectancy:	
Male (as of 1990)	66.6
Female (as of 1990)	69.8
Unemployment rate	2.3%
Percentage of the workforce in:	
Agriculture	60.4
Industry	20.7
Other (primary service sector)	18.9

139. Chinese primary export and import products as of 1992 are listed below.

	Exports (US $ million)	*Imports (US $ million)*
Manufactured goods	16,139	19,298
Machinery and equipment	13,219	31,313
Food	8,353	3,146
Mineral fuels and petroleum	4,692	3,570
Chemicals	4,347	11,158
Raw materials	3,144	5,774
Other	35,103	6,350
	84,997	80,609

TAXES

140. In China, taxes fall into two broad categories: direct taxes and indirect taxes.

Principal Types

141. Direct taxes are mainly based on income or capital gains, and include the following:

- Corporate income tax
- Personal income tax
- Housing and property tax

142. Indirect taxes are essentially taxes on expenditures, whereby the tax burden can be shifted from the producers and retailers to consumers. The major types of indirect taxes include the following:

- Custom duties
- Value-added tax
- Consumption tax
- Business tax

Corporate Income Taxes

143. Corporate income taxes, based on taxable income (from both domestic and foreign sources), are applicable to domestic corporations, except for banking and insurance companies. The current standard rate is 33 percent. Income from foreign sources should be included in the taxable income, and tax paid abroad may serve as a tax credit applied to the Chinese taxes payable (limited by domestic tax laws).

144. Special income tax exemptions and deductions are available to business entities with foreign capital and to Chinese corporations located in the special economic zones. The preferential policies vary based on geographical location and industry.

145. Operating losses in the current period can be carried forward for five years to offset future profits. Losses cannot be carried back to prior periods.

Personal Income Taxes

146. According to the Tax Act for Personal Income (1980 and amended 1993), Chinese citizens and foreigners living in China for more than one year, except for those persons exempted by the state authorities, pay personal income taxes if their monthly total income (including interest and dividend income) is over RMB ¥800. Varied tax rates are applied according to the type of income earned. Wages are subject to a progressive tax rate of 5 to 45 percent. Other personal income such as service compensation, rental income, interest income, and incidental income are taxed at a flat rate of 20 percent after a deduction allowance. A penalty is imposed for any default or evasion of the personal income tax.

Property Taxes

147. Property tax is levied on the owners of residential properties, resources, and automobiles or other transportation vehicles. Varied rates are applicable based on the type of property owned.

148. The Chinese government plans to levy a tax on land development and real estate projects.

Indirect Taxes

149. Indirect taxes levied include—

- Value-added tax based on the portion of value added on sales of goods and services. It is applicable to most businesses. Tax rates varying from 13 to 17 percent.
- Consumption tax levied on certain categories of consumable goods (such as tobacco, alcohol, automobiles, gasoline, and precious metals).
- Business tax applicable to certain service industries (including real estate) that are not covered by the value-added tax. The tax is based on sales volume in the period, with rates from 3 to 20 percent.

Local Government Taxes

150. Various levels of local government have the authority to impose certain supplementary taxes, such as income taxes, adjustment (regulatory) tax on energy usage, land usage tax, surtax for

transportation funding, and the like. The rates vary significantly among local jurisdictions.

151. According to the statutory requirements, all entities and individuals must register with the tax authority no later than thirty days after obtaining their business license.

152. Taxable entities should maintain their accounting records following the statutory financing and accounting requirements recognized by the tax authority.

Tax Returns

153. Income tax is levied under the Law of Taxation Administration of The People's Republic of China, as well as under a series of related taxation statutes, such as the Income Tax Act of the People's Republic of China for the Business Enterprises With Foreign Capital and Foreign Corporations, and the Tax Act for Personal Income.

154. Along with the obligation to submit income tax returns, all taxpayers must disclose their sources of taxable income for each year of assessment. Each type of tax is assessed separately, but the following fundamental principles are applicable to all taxes.

a. Taxes are levied at fixed rates, and the tax authority may periodically revise the rates for specific types of tax.

b. Tax reduction or exemption is permitted for particular types of businesses or products. Both central and local taxation authorities can decide, on the basis of individual assessments, the scope and magnitude of the tax exemption or reduction. Usually, the tax exemption or reduction is used as a part of government incentives to promote growth of particular sectors of the economy or the development of specific geographic areas.

155. Tax returns must be filed with the taxation authority within specified deadlines. A tax remittance is required by the tax authority. Those advance tax payments are treated as a deposit or "tax provision" against the final tax due. The final tax returns should be completed within four months after year-end.

Tax Penalty

156. According to the Law of Taxation Administration, the tax authority may impose various penalties for tax default or evasion. The local taxation departments have the authority to withhold and dispose of a taxpayer's property if he or she does not comply with the penalty.

APPENDIX A

Outstanding Auditing Pronouncements

The outstanding auditing pronouncements as of February 1994 are as follows.

Statement of Auditing Standards

Standards for Financial Statement Examination and Auditing by CPAs (1988)

Statements of Auditing Guidelines

Guidelines for Capital Assessment and Certification (1991)
Guidelines for Auditing and Examination Planning (1991)
Guidelines for Auditing and Examination Working Papers (1992)
Guidelines for Auditing and Examination Reporting (1992)
Guidelines for Letter of Management Recommendations (1992)

Statement of Ethical Behavior

Ethical Code of Professional Conduct for CPAs (1992)

Other

Education Requirement and Training System for CPAs (1992)
Procedures for Performance Evaluation of CPA Firms (1992)

APPENDIX B

Outstanding Accounting Pronouncements

The outstanding accounting pronouncements as of February 1994 are as follows:

The Accounting Act of the People's Republic of China (1984, amended 1993)

Accounting Standards for Business Enterprises (1992)

General Standards for Business Financing (1992)

Accounting Regulation of the People's Republic of China for Business Enterprises With Foreign Capital (1992)

Accounting System for Industrial Enterprises (1993)

Accounting System for Enterprises in Commerce and Trade (1993)

Accounting System for Enterprises in Foreign Trade and Economic Cooperation (1993)

Accounting System for Financial Institutions (1993)

Accounting System for Business Enterprises in the Construction Industry (1993)

Accounting System for the Transportation Industry (1993)

Accounting System for Enterprises in Tourism and Service Industry (1993)

Accounting System for the Geological and Mineral Industry (1993)

Accounting System for Business Enterprises in Aviation and Aerospace Industry (1993)

Accounting System for Business Enterprises in Telecommunication and Television Industry (1993)

Accounting System for the Insurance Industry (1993)

Accounting System for Business Enterprises in Real Estate Development and Operation (1993)

Accounting System for the Railway Industry (1993)

Regulation on Information Disclosures for Securities Listing and Trading (1993)

APPENDIX C

Illustrative Auditor's Report and Financial Statements

The following financial statements are intended for illustrative purposes. The statements presented are not intended to include all information that Chinese law requires.

[Name of client]:

I (we), certified public accountant(s), have examined the balance sheet on *[date, month, and year]*, the statement of profit and loss, and the statement of changes in financial position to the end of this year, of *[company's name]*, according to the requirement in your engagement letter *[file number of the document]*. The beginning balances in the balance sheet and the comparative data of the prior period in the statement of profit and loss have been verified by me (or other auditor). I (we) have complied with the related laws, legislations, financial accounting regulations, and the requirements of the *Guidelines for Auditing Financial Statements by Certified Public Accountants* in our examinations and have conducted necessary audit procedures for tests of internal control compliance and correctness of the record keeping.

In my (our) opinion, the mentioned financial statements of *[company's name]* are in conformity with the requirements of the relevant government accounting regulations and reflect adequately the company's financial position at year-end and the operating results and changes in financial position during the year. The accounting procedures, classification, and presentation of the financial statement items are applied consistently with those of the previous year.

[Signature]
Certified Public Accountant

[Official seal]
Accounting Firm

[Date, month, year]

[Address]

BALANCE SHEETS
At December 31, 1993
(Expressed in 1,000 RMB ¥)

	Note	*19XX*	*19XY*
ASSETS			
Current Assets			
Cash and bank balances	2	1,689	2,491
Short-term investments		1,416	1,002
Notes receivable		156	89
Accounts receivable		1,034	1,344
Deduct: Allowance for bad debts		(26)	(41)
Net balance		1,008	1,303
Advance payment		1,884	1,037
Other receivables		603	809
Deferred expenses		405	485
Inventories	3	13,402	9,945
Total current assets		20,563	17,161
Long-Term Investments	4	3,331	3,031
Fixed Assets			
Book values	5	131,020	120,604
Deduct: Accumulated depreciation		(34,450)	(30,050)
Net book value		96,570	90,554
Intangible and Other Assets			
Intangible	6	5,825	5,490
Start-up costs		1,398	1,599
Long-term deferred costs		4,014	4,586
Sum of intangible and other assets		11,237	11,675
Total Assets		131,701	122,421

	Note	*19XX*	*19XY*
LIABILITIES			
Current Liabilities			
Demand loans		4,054	2,108
Notes payable		1,840	540
Accounts payable		3,104	1,978
Customer deposit		506	1,843
Welfare fund payable		804	930
Dividend payable		689	1,422
Taxes payable	7	4,165	3,216
Other payable		471	206
Accrued expenses	8	1,809	2,606
Total current liabilities		17,442	14,849
Long-Term Liabilities			
Long-term borrowing	9	4,252	5,037
Corporate bonds	10	5,501	4,885
Total long-term liabilities		9,753	9,922
Total Liabilities		27,195	24,771
OWNER'S EQUITY			
Capital	11	65,000	62,000
Capital reserves		11,684	10,946
Surplus reserves	12	24,742	21,854
Welfare reserves		1,603	1,423
Unallocated profits		1,477	1,427
Total owner's equity		104,506	97,650
Total Liabilities and Owner's Equity		131,701	122,421

CONSOLIDATED STATEMENT OF PROFIT AND LOSS
For the year ended December 31, 1993
(Expressed in 1,000 RMB ¥)

	Note	19XX	19XY
Sales	13	46,573	36,704
Deduct:			
Cost of goods sold	14	(24,011)	(19,208)
Selling expenses	15	(3,985)	(2,789)
Administration	16	(4,602)	(4,049)
Financing expenses	17	(1,038)	(533)
Taxation	18	(6,520)	(5,601)
Operating profit (loss)		6,417	4,524
Add: Other income (loss)		(809)	–
Profit (Loss) from operations		5,608	4,524
Add: Investment income	19	2,406	1,986
Nonoperating receipts	20	437	304
Deduct: Nonoperating disbursements	20	(893)	(1,126)
Net Profit (Loss)		7,558	5,688

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

For the year ended December 31, 1993
(Expressed in 1,000 RMB ¥)

	19XX	*19XY*
Sources and Application of Funds		
Sources of funds:		
1. Net profit:	7,558	5,688
Add: Expenses and losses not involving the movement of funds:		
Depreciation	4,400	3,901
Amortization of intangible	2,083	1,743
Disposal loss on fixed assets	–	1,141
	14,041	12,473
2. Other sources:		
Disposal gains on fixed assets	360	–
Increase in long-term liabilities	–	4,104
Transfer-out of fixed assets	1,534	–
Increase in capital accounts	6,856	2,537
	8,750	6,641
Total sources of funds	22,791	19,114
Application of Funds:		
1. Profit allocation:		
Income tax	2,965	2,104
Capital and surplus reserves	1,845	1,274
Welfare reserves	529	409
Dividend paid to shareholders	2,169	1,644
	7,508	5,431
2. Other application:		
Increase in fixed assets	12,360	5,388
Increase in intangible and other assets	1,642	2,583
Decrease in long-term liabilities	169	2,064
Increase in long-term investments	304	3,962
	14,475	13,997
Total application of funds	21,983	19,428
Increase (Decrease) in Working Capital	808	(314)

(Continued on next page.)

	19XX	*19XY*
Changes in Working Capital		
Increase (Decrease) in Current Assets		
Cash and bank balances	(802)	444
Short-term investments	414	(203)
Notes receivable	67	180
Accounts receivable	(295)	375
Advance payment	847	506
Other receivables	(206)	–
Deferred expenses	(80)	844
Inventories	3,457	1,328
Net increase	3,402	3,474
Increase (Decrease) in Current Liabilities		
Demand loans	1,946	763
Notes payable	1,300	(883)
Accounts payable	1,126	455
Customer deposits	(1,336)	–
Welfare fund payable	(126)	337
Dividend payable	(733)	495
Taxes payable	949	1,063
Other payable	265	1,364
Accrued expenses	(797)	194
Net increase	2,594	3,788
Increase (Decrease) in Working Capital	808	(314)

STATEMENT OF PROFIT ALLOCATION
For the year ended December 31, 1993
(Expressed in 1,000 RMB ¥)

	19XX	*19XY*
Net Profit	7,558	5,688
Add: Beginning balance of unallocated profit (loss)	1,427	930
Transfer from reserves	–	383
Profit available for allocation	8,985	7,001
Deduct: Income tax	(2,965)	(2,275)
Statutory reserves	(756)	(570)
Welfare reserves	(529)	(398)
Profit available for allocation to shareholders	4,735	3,758
Deduct: Dividends paid on preferred shares	(1,023)	(1,002)
Surplus reserves	(1,089)	(495)
Dividends paid on common shares	(1,146)	(834)
Ending balance of unallocated profit	1,477	1,427

NOTES TO THE FINANCIAL STATEMENTS

1. Principal Accounting Policies

a. Basis of accounting

1. The accounts have been prepared in conformity with statutory accounting principles, except for minor modification to the chart of accounts and the format of the financial statements.
2. Valuation of assets and liabilities is on the basis of the historical (actual) cost principle and in accordance with the provisions of statutory accounting standards. Revaluation is done only for those inventories for which the state has official adjusted prices during the year, and for those fixed assets being used as investments. Differences between the original book value and revaluation are recorded as charges or credits to the capital reserves.
3. Assets and liabilities are classified under current and long-term subcategories. Items that are expected to be realized during the next calendar year are classified as short-term assets or liabilities and disclosed separately on the balance sheet.

b. Basis of consolidation

1. The consolidated financial statements include the accounts of the holding company and the subsidiaries in which the company holds an equity interest exceeding 50 percent or exerts dominant influence, together with the group's share of the results of related companies at the end of the year.
2. Associated companies are companies other than subsidiaries, in which the group's interest is held for long-term purposes and is substantial. Differences between valuation and carrying value are recorded as credits or charges to the capital reserves. The cost method is applied if the group's interest in an associated company is less than substantial.

c. Investment properties

1. Land and buildings held for rental purpose are included as fixed assets.
2. Investment properties owned by the group are stated at cost throughout the course of development until the completed development achieves a mature state of income generation.
3. Profits on sale of investment properties in the ordinary course of business are included in the operating profit of the group.

d. Development properties

1. Properties developed or under construction and properties acquired for future development projects with the intention of resale (within one year) are classified under current assets at cost.

2. When properties are developed for resale, income is recognized when the sales agreement goes into effect. Profit or loss arising from sales of an entire development project prior to completion are recognized when the contract is signed.

e. Listed securities

Listed securities included under current assets are stated at cost.

f. Translation of foreign currency

Foreign currency balances at the end of the year are translated at the exchange rate on the balance-sheet date. Foreign currency transactions during the year are translated into RMB ¥ at the exchange rates prevailing at the transaction dates. Differences in foreign currency translation are a component of financing expenses and are included in the statement of profit or loss.

g. Depreciation and amortization

Depreciation on fixed assets is calculated at cost on a straight-line basis over the estimated useful lives of the assets. Depreciation rates stipulated by the finance department have been employed.

h. Nonoperating receipts (gains) and disbursements (losses)

Items in the nonoperating receipts (gains) and disbursements (losses) are in accordance with the criteria specified by the finance and taxation authorities. They are treated as additions or deductions to the profit or loss in the period.

i. Changes in accounting policies

Certain accounting policies have been adjusted as a result of the implementation of *Accounting Standards for Business Enterprises, Financing Standards for Business Enterprises,* and *Accounting Regulation for Industrial Enterprises (1993).* The comparative figures for the prior year have been restated to reflect these changes.

2. Cash and bank balances (expressed in 1,000 RMB ¥)

	19XX
Cash on hand	56
Bank balances	1,633
	1,689

3. Inventories (expressed in 1,000 RMB ¥)

	19XX	19XY
Raw materials	3,204	2,941
Purchased goods in transit	1,445	1,359
Work in process	1,826	2,032
Finished products	3,873	3,613
Properties to be sold within one year	3,054	–
	13,402	9,945

4. Long-term investments (expressed in 1,000 RMB ¥)

	19XX	19XY
Long-term treasury bonds (maturity, 20Y2)	1,000	1,000
Interest in subsidiary	1,356	1,279
Less: Amount due to subsidiary	(305)	(247)
	1,051	1,032
Investment in associated companies	1,224	886
Share of undistributed post-acquisition reserves	416	293
Less: Amount due to associated companies	(360)	(180)
	1,280	999
	3,331	3,031

5. Fixed assets (expressed in 1,000 RMB ¥)

	Original book values		*Accumulated depreciation*		*Depreciation expense*	
	1/1	*12/31*	*1/1*	*12/31*	*Rate %*	*Amount*
Plant and building	62,056	66,096	13,226	14,503	2	1,277
Machine and equipment	27,061	30,917	7,624	9,266	10	1,642
Transportation facility	14,607	13,687	2,417	2,983	10	566
Furniture and office supplies	4,456	5,376	1,808	2,237	20	429
Specific tools and instruments	12,424	14,944	4,975	5,461	12	486
	120,604	131,020	30,050	34,450		4,400

6. Intangibles (expressed in 1,000 RMB ¥)

	Goodwill	*Know-how*	*Total*
January 1	2,740	2,750	5,490
Increase during the year	1,402	–	1,402
Amortization	(1,067)	–	(1,067)
	3,075	2,750	5,825

7. Tax payable (expressed in 1,000 RMB ¥)

	19XX	*19XY*
Value-added tax	1,340	1,011
Sales tax	875	944
Income tax	1,950	1,261
	4,165	3,216

8. Accrued expenses (expressed in 1,000 RMB ¥)

	19XX	*19XY*
Provision for seasonal operation	–	1,860
Provision for major repair and maintenance	1,809	746
	1,809	2,606

9. Long-term borrowing (expressed in 1,000 RMB ¥)

	19XX	*19XY*
Bank loans—secured	1,252	4,037
Export development—unsecured (Due August 1, 19XZ)	3,000	1,000
	4,252	5,037

10. Corporate bonds (expressed in 1,000 RMB ¥)

	19XX	*19XY*
8.75% debenture	–	2,015
9.50% debenture	2,936	2,870
12.00% debenture	2,565	–
	5,501	4,885

11. Capital (expressed in 1,000 RMB ¥)

	19XX	19XY
Class A common shares (authorized 50,000,000 shares)	62,000	62,000
Class B common shares (at par, RMB ¥1)	3,000	–
	65,000	62,000

12. Surplus reserves (expressed in 1,000 RMB ¥)

	19XX	19XY
Statutory reserves	10,841	10,085
General reserves	13,901	11,769
	24,742	21,854

13. Sales (expressed in 1,000 RMB ¥)

	19XX	19XY
Sales	48,901	37,980
Less: Returned goods	(2,328)	(1,276)
	46,573	36,704

14. Cost of goods sold (expressed in 1,000 RMB ¥)

	19XX	19XY
Cost of goods sold	17,527	13,564
Depreciation	4,400	3,901
Amortization	2,084	1,743
	24,011	19,208

15. Sales expenses (expressed in 1,000 RMB ¥)

	19XX	19XY
Sales commission	1,844	1,601
Transportation	306	290
Insurance	312	318
Promotion	1,415	396
Product warranty	108	184
	3,985	2,789

16. Administration (expressed in 1,000 RMB ¥)

	19XX	*19XY*
General administration	2,213	2,402
Board of director's expenses	665	596
Travel and entertainment	780	310
Research and development	421	228
Legal fees	315	298
Accounting fees	208	215
	4,602	4,049

17. Financing expenses (expressed in 1,000 RMB ¥)

	19XX	*19XY*
Interest	778	618
Exchange gains and losses on projects under development	260	(85)
	1,038	533

18. Taxation (expressed in 1,000 RMB ¥)

	19XX	*19XY*
Value-added tax	2,508	2,372
Sales tax	1,047	954
Income tax	2,965	2,275
	6,520	5,601

19. Investment income (expressed in 1,000 RMB ¥)

	19XX	*19XY*
Interest	1,094	1,293
Dividend	1,312	693
	2,406	1,986

20. Nonoperating receipts (gains) and disbursement (losses) (expressed in 1,000 RMB ¥)

	19XX	*19XY*
Receipts (gains):		
Fixed assets disposal	286	—
Revaluation surplus	—	218
Other	151	86
	437	304
Disbursements (losses):		
Revaluation	577	—
Disposal	—	578
Penalty payment	—	240
Donation	316	—
Extraordinary	—	308
	893	1,126
Net gains (losses)	(456)	(822)

APPENDIX D

Checklist for Comparison of Generally Accepted Auditing Standards (GAAS) in the United States With Auditing Standards in China

General Information	Answer	Comments
1. Is a primary purpose of an audit—		
a. To attest to information used by investors, creditors, etc.?	No	
b. To satisfy statutory requirements (for example, the Companies Act)?	Yes	1*b*,*c*. The requirements are included in the Company Act and the Income Tax Law for Businesses With Foreign Investments.
c. For tax purposes?	Yes	

Notes:

Checklist was completed from the perspective of performing a local audit, *not* a referral audit.
AU numbers refer to sections in the *Codification of Statements on Auditing Standards*, unless otherwise noted.
This checklist does not include the latest GAAS pronouncements issued in the United States.

General Information	Answer	Comments
2. A. The United States has ten generally accepted auditing standards including general standards, standards of field-work, and standards of reporting. Those standards and their interpretations constitute U.S. generally accepted auditing standards, which have been published in *Codification of Statements on Auditing Standards.*[1] Do generally accepted auditing standards exist in China?	Yes	
B. If so, are they published?	Yes	2B. They are published in the audit guidelines issued by the CICPA.
C. If auditing standards exist in China, are they similar to U.S. standards?	Yes	
D. If not, what are they?		
3. Who is responsible for promulgating auditing standards (for example, the profession, a governmental body, etc.)?	The profession	3. As authorized by the CPA Act, the CICPA is responsible for setting audit standards.

U.S. Generally Accepted Auditing Standards	Required by Government or Professional Pronouncements	Predominant Practice	Minority Practice	Not Done	Comments
4. Do auditors confirm receivables? (AU 330)	Yes. *Standards for Financial Statement Examination and Auditing by CPAs*	✓			
5. Do auditors observe inventory counts? (AU 331)	Yes. *Standards for Financial Statement Examination and Auditing by CPAs*	✓			

6. Do auditors receive written representations from management? (AU 333)	Yes. *Standards for Financial Statement Examination and Auditing by CPAs*	✓		
7. Do auditors receive written representations from management's legal counsel? (AU 337)	No		✓	
8. A. Do auditors prepare and maintain working papers? (AU 339)	Yes. *Guidelines for Auditing and Examination Working Papers*	✓		8A. The CICPA has recommended standardized forms of audit working papers.
B. If so, do they include a written audit program outlining procedures to be performed? (AU 339)	Yes. *Guidelines for Auditing and Examination Working Papers* and *Guidelines for Auditing and Examination Planning*	✓		
9. Do auditors obtain a sufficient understanding of the internal control structure to plan the audit and to determine the nature, timing, and extent of tests to be performed? (AU 319)	Yes. *Guidelines for Auditing and Examination Planning* and *Standards for Financial Statement Examination and Auditing by CPAs*	✓		
10. A. Do auditors communicate reportable conditions in the internal control structure to the audit committee? (AU 325)	No		✓	10A. There is no requirement for an audit committee in China, but the auditor must communicate significant internal control deficiencies to the client's senior management.

[1]American Institute of Certified Public Accountants. *Codification of Statement on Auditing Standards.* Chicago, Ill.: Commerce Clearing House, 1994.

U.S. Generally Accepted Auditing Standards	Required by Government or Professional Pronouncements	Predominant Practice	Minority Practice	Not Done	Comments
B. If so, is the communication documented? (AU 325)					
11. In obtaining evidential matter, does the auditor apply either statistical or nonstatistical procedures? (AU 350)	Yes. *Standards for Financial Statement Examination and Auditing by CPAs*	✓			11. Nonstatistical procedures are more popular in practice.
12. Is the auditor responsible for designing the audit to provide reasonable assurance of detecting errors and irregularities that are material to the financial statements? (AU 316)	Yes. *Standards for Financial Statement Examination and Auditing by CPAs* and *Guidelines for Auditing and Examination Reporting*	✓			12. The auditor has a responsibility for detecting and reporting any violation of government law, as well as accounting errors and management misconduct.
13. A. Does the auditor perform procedures to identify related-party transactions and their effect on the financial statements? (AU 334)	No			✓	
B. If so, list the procedures.					
14. Does the auditor consider the adequacy of cutoff procedures to ensure that movements into and out of inventories are properly identified in the accounting records? (AU 313)	Yes. *Standards for Financial Statement Examination and Auditing by CPAs*	✓			14. The cutoff test is a standard audit procedure for the inventory examination.
15. A. Are specific auditing procedures applied to transactions occurring after the balance sheet date? (AU 560)	Yes	✓			

B. Are other auditing procedures applied to ascertain the occurrence of subsequent events that require adjustment to or disclosure in the financial statements? (AU 560)	Yes. *Standards for Financial Statement Examination and Auditing by CPAs* and *Guidelines for Auditing and Examination Reporting*	✓		15B. The auditor determines if the subsequent events should be disclosed or if the financial statement should be adjusted.
16. The concept of "joint auditors" in certain countries (for example, the United Kingdom, Canada, and Australia) is that two auditors or audit firms jointly audit the financial statements of a company and issue a single report signed by the two firms. This practice is not generally followed in the United States. Does the concept of "joint auditors" exist in China?	Yes. *Guidelines for Auditing and Examination Planning*	✓		16. "Joint audit" is not utilized often. The division of duty and responsibility, as well as coordination among joint auditors, should be clearly specified.
17. When a principal auditor is reporting on financial statements that include one or more subsidiaries, divisions, branches, or investees: (AU 543)				
A. Must the principal auditor assume responsibility for the work of the other auditor as it relates to the principal auditor's opinion?	No		✓	17A. Not specified. However, *Ethical Code of Professional Conduct* states that the principal auditor should review all working papers.
B. May the principal auditor decide not to assume that responsibility by making reference to the other auditor and indicating the division of responsibility?	No		✓	

U.S. Generally Accepted Auditing Standards	Required by Government or Professional Pronouncements	Predominant Practice	Minority Practice	Not Done	Comments
18. A. Is there a standard form of auditor's report? (AU 508)	Yes. *Guidelines for Auditing and Examination Reporting*		✓		18A. The CICPA has recommended standardized formats for the various types of audit report.
B. List the circumstances that require a departure from the standard report and indicate the type of report required. (AU 508)					18B. Qualified opinion will be issued in the following situations: • Certain accounting treatment or the presentation of significant items that depart from statutory requirements • Inaccuracy of financial statement items that have an impact on the financial position, operating results, and changes in financial position • Treatment of some accounting events or presentation of certain items that are inconsistent with the prior practice • There exists significant uncertainty and its impact on related financial statement items is difficult to adequately project • Audit scope is restricted by the client and the auditor is unable to perform the necessary audit procedures An adverse opinion should be rendered if the above departures are significant.

19. A. Does the auditor's report require an explanatory paragraph for a change in accounting principles or in the method of their application? (AU 508)	Yes. *Guidelines for Auditing and Examination Reporting*	✓	
B. If not, does it imply that either consistency exists or the financial statements disclose the inconsistency?			
20. A. Is the auditor's report dated as of the last day of fieldwork? (AU 530)	Yes. *Guidelines for Auditing and Examination Reporting*	✓	
B. If not, what date is used?			
21. To express an opinion, must the auditor be independent? For the purpose of this checklist, independence is defined as being free of financial interest in the client. (Code of Professional Conduct, rule 101 and its interpretations.)	Yes. *Standards for Financial Statement Examination and Auditing by CPAs* and *Ethical Code of Professional Conduct for CPAs*	✓	21. An auditor who has a personal interest and connection with the client should not be involved in the engagement.
22. Please describe any standards in China for which there are no corresponding U.S. standards.			22. The CICPA has issued the following guidelines regarding public practice: • *Guidelines for Capital Assessment and Certification* • *Educational Requirements and Training System for CPAs* • *Guidelines for Letter of Management Recommendations* • *Procedures for Performance Evaluation of CPA Firms*

APPENDIX E

Checklist for Comparison of Generally Accepted Accounting Principles (GAAP) in the United States With Accounting Principles in China

General Information	Answer	Comments
1. Are there generally accepted accounting principles in China? If so, are they codified?	Yes	1. They are codified as— *a.* *Accounting Standards for Business Enterprises* (*AS*) 1992 *b.* *General Standards for Business Financing* (*FS*) 1992 *c.* A series of accounting regulations by industry and ownership
2. Who is responsible for promulgating accounting principles (for example, the profession, a governmental body, etc.)?		2. All accounting standards and regulations are promulgated by the State Ministry of Finance.

U.S. Generally Accepted Accounting Principles	Required by Government or Professional Pronouncements	Predominant Practice	Minority Practice	Not Done	Comments
3. Are assets and liabilities recorded on the historical-cost basis?	Yes. *AS*	✓			3. Historical-cost valuation basis is specified for valuation of assets and liabilities.

4. Are interest costs, incurred while activities that are necessary to get an asset ready for its intended use are in progress, capitalized as part of the historical cost of an asset? (I67)	Yes. *AS* and *FS*	✓		
5. A. Is a general revaluation (either upward or downward) of assets permitted? (D40)	See comment		✓	5A. Revaluation is allowed only to record the state's price adjustment or a business reorganization approved by the Ministry of Finance.
B. If so, define the basis.	See comment			5B. Replacement cost of the assets
6. Are nonmonetary transactions that culminate an earnings process accounted for on the basis of the fair market value of the assets involved when that value is determined within reasonable limits? (N35)	No	✓		
7. Is revenue recognized when it is earned and its realization is reasonably assured (rather than when money is received)? (Statement of Financial Accounting Concepts No. 5)	Yes. *AS* and *FS*	✓		
8. Are costs recorded when incurred rather than when money is paid? (Statement of Financial Accounting Concepts No. 5)	Yes. *AS* and *FS*	✓		

Notes:

References to the U.S. Generally Accepted Accounting Principles column are to sections in the *FASB Current Text*, unless otherwise noted.
This checklist does not include the latest GAAP pronouncements issued in the United States.

U.S. Generally Accepted Accounting Principles	Required by Government or Professional Pronouncements	Predominant Practice	Minority Practice	Not Done	Comments
9. A. Are consolidated financial statements required when one company has controlling financial interest over another company? (C51)	Yes. *AS*		✓		
B. Is control usually indicated by ownership of over 50 percent of the outstanding voting shares? If not, how is control indicated?	Yes. *AS*		✓		
10. A. Are there instances when an entity would not be consolidated even though control is present? (C51)	Yes. *AS*		✓		
B. If so, list them.	See comment				10B. If the subsidiary operates in a different business line or when consolidation is deemed inappropriate.
11. If consolidation is not otherwise appropriate, is the equity method used for unconsolidated subsidiaries, corporate joint ventures, and other investees, if the investments give the investor the ability to exercise significant influence over the investees' operating and financial policies? (I82)	Yes. *AS*	✓			
12. Are there two methods of accounting for business combinations: the pooling-of-interests method and the purchase method? (B50)	No			✓	12. Pooling-of-interests method is not permitted.

13. Is the method used to account for a business combination disclosed? (B50)	No			✓	
14. A. Do criteria exist for treatment of business combinations as poolings of interests? (B50)	No			✓	
B. If so, list the criteria.					
15. A. Is goodwill arising from a business combination accounted for as an asset? (I60)	Yes. *AS* and *FS*	✓			
B. If so, is it amortized as a charge to income over the period estimated to be benefited?	Yes. *AS* and *FS*	✓			15B. The amortization period is usually stipulated by government authority. If not stipulated, a period of at least ten years is applicable.
16. Are the following disclosures made for related-party transactions: (R36)					
a. The nature of the relationship?	Yes		✓		
b. A description of the transactions for the periods presented?	No		✓		
c. The amounts of the transactions for the periods presented?	No			✓	
d. The amounts due to or from related parties at the balance sheet date?	Yes		✓		
17. Is an estimated loss from a loss contingency accrued only if it is probable that an asset has been impaired or a liability incurred and the amount of loss can be reasonably estimated? (C59)	No			✓	17. Losses can only be recognized when they have actually occurred.

U.S. Generally Accepted Accounting Principles	Required by Government or Professional Pronouncements	Predominant Practice	Minority Practice	Not Done	Comments
18. If a loss contingency is not accrued because both conditions for accrual listed in question 17 are not met, is disclosure of the contingency required when there is at least a reasonable possibility that a loss may have been incurred? (C59)	No		✓		
19. Are guarantees of the indebtedness of others or other loss contingencies disclosed in financial statements even though the possibility of loss may be remote? (In the United States, guarantees are usually disclosed as loss contingencies even if the possibility of loss is remote.) (C59)	No			✓	
20. Are the following items disclosed in a public enterprise's financial statements for each industry segment: (S20)					20. There is no official requirement of segmental disclosure.
a. Sales to outsiders and intersegment sales?	No			✓	
b. Operating profit or loss?	No			✓	
c. Identifiable assets and related depreciation, depletion, and amortization expense?	No			✓	
d. Capital expenditures?	No			✓	
e. Equity in net income and net assets of unconsolidated subsidiaries and other investees?	No			✓	

f. Effect of a change in accounting principle?	No			✓	
21. A. Are there any requirements or recommendations to disclose the effects of inflation? (C28)	No		✓		21. The effect of inflation may be disclosed in management's analysis of financial position.
B. If so, list the disclosures required.					
22. Are assets segregated into current and noncurrent classifications with a total for current assets presented? (B05)	Yes. *AS*	✓			
23. A. Are noncurrent assets those not expected to be realized within one year or the current operating cycle? (B05)	Yes. *AS*	✓			
B. If not, how are noncurrent assets defined?					
24. A. Is an allowance established for uncollectible receivables? (C59)	Yes. *AS* and *FS*	✓			
B. If so, what is the basis (for example, percentage of sales, aging of receivables, etc.) for calculating the allowance?	See comment	✓			24B. The allowance is based on total year-end receivables.
25. Are receivables and payables not arising in the normal course of business or subject to normal trade terms recorded at an amount that takes imputed interest into account? (I69)	No			✓	
26. A. Is inventory stated at the lower of cost or market (or net realizable value)? (I78)	No			✓	
B. If not, how is inventory stated?	See comment	✓			26B. Inventory is stated at historical cost.

U.S. Generally Accepted Accounting Principles	Required by Government or Professional Pronouncements	Predominant Practice	Minority Practice	Not Done	Comments
C. Is the basis disclosed?	Yes. *AS*	✓			
27. Does cost for inventory purposes include— (I78)					
a. Materials?	Yes. *AS* and *FS*	✓			
b. Direct labor?	Yes. *AS* and *FS*	✓			
c. Factory overhead?	Yes. *AS* and *FS*	✓			
d. If the answer to *c* is yes, is an allocable share of all factory overhead included?	Yes. *AS* and *FS*	✓			
28. A. Are the following cost methods permitted for reporting purposes: (I78)					28A. All three methods are permitted. The method used should result in the proper matching of revenues and costs.
a. First-in, first-out (FIFO)?	Yes. *AS*		✓		
b. Last-in, first-out (LIFO)?	Yes. *AS*		✓		
c. Average cost?	Yes. *AS*	✓			
B. Are the same methods permitted for tax purposes?	Yes	✓			28B. Accounting standards and regulations are endorsed by tax laws.
29. Is the inventory costing method used disclosed? (I78)	Yes	✓			
30. A. Are fixed assets depreciated over their estimated useful lives by systematic charges to income? (D40)	Yes. *AS* and *FS*	✓			
B. If so, is an accumulated depreciation account used?	Yes. *AS*	✓			
31. Are disclosures made of— (D40)					

a. Depreciation expense for the period?	Yes	✓		
b. Balances of major classes of depreciable assets?	Yes	✓		
c. The methods used to compute depreciation for the major asset classes?	Yes	✓		31*c.* Straight-line or production capacity is used in most circumstances. Accelerated methods are permitted but must be approved by the government taxation authority.
d. Accumulated depreciation, either by major class of assets or in total?	Yes	✓		
32. A. Do criteria exist for classifying leases as operating leases? (L10)	No		✓	
B. If so, list the criteria and disclosure requirements.				
33. A. Do criteria exist for classifying leases as other than operating leases for the lessor and lessee? (L10)	No		✓	
B. If so, list the criteria, type of lease, and disclosure requirements.				
34. Are liabilities segregated into current and noncurrent classifications with a total for current liabilities presented? (B05)	Yes. *AS* and *FS*	✓		
35. A. Are noncurrent liabilities those whose liquidation is not expected to require the use of current assets or the creation of current liabilities? (B05)	Yes. *AS*	✓		
B. If not, how are noncurrent liabilities defined?				

U.S. Generally Accepted Accounting Principles	Required by Government or Professional Pronouncements	Predominant Practice	Minority Practice	Not Done	Comments
36. For notes payable, is disclosure made of— (C32)					
a. Interest rates?	Yes		✓		
b. Maturities?	Yes		✓		
c. Assets pledged as collateral?	No			✓	
d. Covenants to reduce debt?	No			✓	
e. Minimum working capital requirements?	No			✓	
f. Dividend restrictions?	No			✓	
37. A. For long-term construction-type contracts, are the percentage-of-completion and completed-contract methods used? (Co4)	Yes. *AS*	✓			37A. Either method is permitted.
B. If so, what are the criteria for determining the method used?	See comment				37B. The method used is determined by management.
38. A. Are research costs charged to expense when incurred? (R50)	No	✓			38A. These costs are not officially defined. In practice, research costs are usually expensed.
B. Are such costs disclosed?	No	✓			38B. Although not required, the costs are usually disclosed as separate items in the schedules to the statement of profits and losses.
39. A. Are development costs charged to expense when incurred? (R50)	See comment	✓			39A. The costs are capitalized if they increase the existing capacity of the assets.
B. Are such costs disclosed?	Yes	✓			39B. They are disclosed in the schedule or notes to financial statements.

40. A. In the United States, events and transactions are presented in the income statement as extraordinary items when they are unusual in nature and are of the type that would not reasonably be expected to recur in the foreseeable future. Do similar criteria for identifying extraordinary items exist in China? (I17)	Yes. *AS* and *FS*	✓		
B. If not, what are the criteria?				
41. Are material events or transactions that are unusual in nature or expected to occur infrequently, but not both (and thus do not meet the criteria for classification as extraordinary), shown as a separate component of income or expense? (I22)	No		✓	
42. A. Are disclosures required for—				
a. Extraordinary items? (I17)	No		✓	42*a*. Except for nonoperating receipts and disbursements specified by the finance department.
b. Material events or transactions not classified as extraordinary items? (I22)	No		✓	
c. Disposal of a segment of a business? (I13)	No		✓	
B. Indicate the financial statement presentation of these items.				42B. Details of nonoperating receipts and disbursements are disclosed in the schedules to the statement of profits and losses.

U.S. Generally Accepted Accounting Principles	Required by Government or Professional Pronouncements	Predominant Practice	Minority Practice	Not Done	Comments
43. A. Are pension costs provided for employees over the term of employment? (P16)	No		✓		43A. Only businesses with foreign investment record pension costs.
B. If so, do they include charges for costs assigned under the actuarial method used in years prior to the plan's inception?					
44. A. Are specific disclosures required relating to pension plans? (P16)	No			✓	
B. If so, list them.					
45. A. When accounting income and taxable income differ, are deferred income taxes recorded for temporary differences (as opposed to permanent differences)? (I27)	No			✓	45A. Accounting income should equal taxable income, thus no deferred tax is recorded.
B. If so, are deferred taxes provided for all temporary differences (as opposed to only those meeting certain criteria)?					
46. A. Are deferred taxes determined on the basis of current tax rates? (I27)	No			✓	
B. If not, on what basis?					46B. See comment for question 45A.
47. A. Is specific information related to income taxes required to be disclosed? (I27)	Yes. *AS*		✓		

B. If so, list the requirements.					47B. Taxes payable should be disclosed as a separate line item under current liabilities in the balance sheet.
48. A. Are operating losses reported on the income tax return allowed to be carried back to earlier periods? (I27)	No			✓	
B. If so, are the tax effects of a loss carryback included in the income in the period?					
49. A. Are operating losses reported on the income tax return allowed to be carried forward? (I27)	Yes. *AS* and *FS*	✓			49A. The losses can be carried forward up to five years.
B. If so, are the tax effects of a loss carryforward included in the income in the period realized?	No	✓			
50. Are financial statements of a foreign entity prepared for consolidation purposes measured in the currency of the primary economic environment in which the entity operates? (F60)	Yes. *AS* and *FS*		✓		50. Subsidiaries can use foreign currencies as the recording currency, but financial statements for consolidation purposes must use Chinese currency.
51. Are all elements of financial statements translated at current exchange rates? (F60)	Yes. *FS*	✓			51. Translation is done by use of the exchange rates at the balance sheet date.
52. A. Are translation adjustments reported separately? (F60)	Yes. *FS*	✓			52A. Translation gains and losses are included in the income statement.
B. Are they accumulated in a separate component of stockholders' equity until ultimately realized?	No			✓	

U.S. Generally Accepted Accounting Principles	Required by Government or Professional Pronouncements	Predominant Practice	Minority Practice	Not Done	Comments
C. Is there an analysis of the changes during the period in the component of stockholders' equity relating to translation adjustments?	No			✓	
53. A. Are gains and losses resulting from transactions, denominated in a currency other than that of the environment in which the entity operates, included in determining net income for the period in which the exchange rate changes? (F60)	Yes. *FS*	✓			
B. Is the aggregate transaction gain or loss included in determining net income for the period disclosed in the financial statements or notes?	Yes. *FS*	✓			
54. Are gains or losses on foreign currency transactions that are intended to hedge a foreign currency commitment deferred and included in the related transactions? (F60)	No			✓	
55. What information is disclosed about foreign currency restrictions? (F60)	None required			✓	
56. Are significant events arising subsequent to the balance sheet date reflected in the financial statements or notes thereto? (C59)	Yes. *AS* and *FS*		✓		56. They are disclosed in management's analysis of financial position or notes to the financial statements.

57. Please list any standards for China for which there are no corresponding U.S. standards.

57. There are *Rules on Accountant's Work* promulgated by the State Council and certain industrial accounting regulations.

Bibliography

The information in this booklet was compiled from many sources in China. Significant references follow.

The Accounting Law (amended 1993).

The CPA Act (1993).

Accounting Standards for Business Enterprises (1993), *General Standards for Financing of Business Enterprises* (1993), and a series of accounting regulations for industry issued by the State Ministry of Finance.

The Company Act (1993) and a series of business legislation and regulations.

Ethical Code of Professional Conduct (1992).

Auditing guidelines issued by CICPA.

Statistical Bulletins.

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