

China Financial Reporting Update

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2002 Year-End Review

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2002 was a year of continued progress in accounting and financial reporting in China. During the year, the Ministry of Finance (MOF):

- expanded the scope of applicability of the *Accounting System for Business Enterprises (ASBE)*;
- adopted an *Accounting System for Financial Institutions*;
- issued an Exposure Draft of a new *Accounting System for Not-for-Profit Organisations*;
- issued Exposure Drafts for four Chinese Accounting Standards (CASs); and
- published 22 Q&As relating to the ASBE and CASs.

During 2002, the China Securities Regulatory Commission (CSRC) issued a number of regulations, in particular:

- imposed new corporate governance requirements for listed companies;
- allowed foreign investors, for the first time, to buy “A” shares.

These and several other related matters are covered in this Update.

Accounting System for Business Enterprises (ASBE)

During 2002, the MOF extended the applicability of the comprehensive *Accounting System for Business Enterprises* to all foreign investment enterprises (FIEs) – other than banks, insurance companies, and other specialised financial enterprises. The ASBE had been adopted in 2001 and was made applicable in that year to all joint stock limited enterprises (JSLEs) other than banks, insurance companies, and other financial institutions. Enterprises other than FIEs and JSLEs are encouraged to follow the ASBE as well, with the proviso that State-owned enterprises must get prior approval from the relevant government authority. In addition, if a parent company adopts the ASBE, the parent should require its subsidiaries to adopt the ASBE as well.

Late in 2002, the MOF announced its intention to phase in the ASBE over the next three years for all state-owned enterprises.

English Translation of the ASBE

Deloitte Touche Tohmatsu has translated the Accounting System for Business Enterprises into English. The translation may be found on our web site: www.iasplus.com/country/china.htm.

Accounting System for Financial Institutions

Early in 2002, the MOF adopted a new Accounting System for Financial Institutions. It must be applied, starting 1 January 2002, by all listed and foreign investment banks, insurance companies, brokerages, leasing companies, and finance companies. Unlisted financial institutions that are joint stock limited enterprises are encouraged to follow the new system. Other unlisted financial institutions should continue to use the old Accounting Systems for financial institutions.

The Accounting System for Financial Institutions is similar to the ASBE for general business enterprises but, in addition, includes principles specific to financial enterprises, such as:

- how to recognise interest;
- repurchase agreements;
- securities transactions;
- insurance reserves;
- accounting by trusts; and
- accounting by investment funds.

Chinese Accounting Standards (CAS) – Progress to Date

The MOF has been working to develop a body of Chinese Accounting Standards aiming at achieving convergence of CAS with International Accounting Standards (IAS). The MOF issued its first Standard in 1997. To date, 16 standards have been adopted and others are under active development. Deloitte Touche Tohmatsu has served as the advisor to the MOF in its project to develop CAS.

A complete list of CAS is set out in the table below. The table identifies the category of enterprises to which each Standard applies.

	Chinese Accounting Standard	Original Issue Date	Effective Date	Applicability
1	Disclosure of Related Party Relationships and Transactions	22 May 1997	1 January 1997	Listed companies
2	Cash Flow Statements (revised 2001)	20 March 1998	1 January 2001	All companies
3	Events Occurring After the Balance Sheet Date	12 May 1998	1 January 1998	Listed companies
4	Debt Restructuring (revised 2001)	12 June 1998	1 January 2001	All companies
5	Revenue	20 June 1998	1 January 1999	Listed companies
6	Investments (revised 2001)	24 June 1998	1 January 2001	Joint Stock Limited Enterprises
7	Construction Contracts	25 June 1998	1 January 1999	Listed companies

	Chinese Accounting Standard	Original Issue Date	Effective Date	Applicability
8	Changes in Accounting Policies and Estimates and Corrections of Accounting Errors (revised 2001)	25 June 1998	1 January 1999	All companies
9	Non-monetary Transactions (revised 2001)	28 June 1999	1 January 2001	All companies
10	Contingencies	27 April 2000	1 July 2000	All companies
11	Intangible Assets	18 January 2001	1 January 2001	Joint Stock Limited Enterprises
12	Borrowing Costs	18 January 2001	1 January 2001	All companies
13	Leases	18 January 2001	1 January 2001	All companies
14	Interim financial reporting	9 November 2001	1 January 2002	Listed companies
15	Inventories	9 November 2001	1 January 2002	Joint Stock Limited Enterprises
16	Fixed assets	9 November 2001	1 January 2002	Joint Stock Limited Enterprises

Although the scope of applicability of each CAS is different, many of the issues addressed in individual CAS are also included in the ASBE, which is applicable to FIEs and JSLEs. The ASBE is consistent with those standards, though there is generally more detail in the individual standards and supporting guidance than there is in the ASBE.

During 2002, MOF issued Exposure Drafts of four additional CAS:

- Accounting for Government Grants and Assistance
- Presentation of Financial Statements
- Earnings per Share
- Discontinuing Operations

Accounting Standards – Prospects for 2003/2004

The table below indicates the accounting standards projects on which MOF is now working and prospects for progress in the coming year:

	Exposure Draft	Final Standard
Accounting for Government Grants and Assistance	Issued 2002	Expected 2003
Presentation of Financial Statements	Issued 2002	Expected 2003
Earnings per Share	Issued 2002	Expected 2003
Segment Reporting	Issued 2001	Expected 2003
Foreign Currency Translation	Issued 1995; revised draft circulated 2001	Expected 2003
Discontinuing Operations	Issued 2002	Expected 2003
Business Combinations	Expected 2003	Expected 2003
Consolidated Financial Statements	Expected 2003	Expected 2003
Impairment	Expected 2003	Expected 2003

	Exposure Draft	Final Standard
Disclosure by Banks and Other Financial Institutions	Expected 2003	Expected 2003/2004
Disclosure and Presentation of Financial Instruments	Expected 2003	Expected 2003/2004
Agriculture	Expected 2003	Expected 2003/2004
Oil and Gas	Expected 2003	Expected 2003/2004
Other Extractive Industries (mining, etc.)	Expected 2003	Expected 2003/2004
Income Taxes	Expected 2003	Expected 2003/2004
Liquidation Accounting	Expected 2003	Expected 2003/2004

In addition to the above accounting standards projects, MOF is also formulating an accounting system for small-sized enterprises.

Q&A on Adoption of the ASBE

In October 2002, MOF published Caikuai [2002] No. 18, *Q&A Relating to the Adoption of the Accounting System for Business Enterprises and Related Accounting Standards*. The document provides guidance for applying the ASBE on the following matters:

- Whether advertising cost can be deferred or accrued in advance.
- How to allocate an expense that relates to an enterprise and one or more of its related parties.
- When to start and stop amortising intangible assets.
- What should be considered in changing accounting policies and estimates.
- Method used to determine the provision for bad debts.
- Bad debt provisions for related party balances.
- How to analyse the age of outstanding debt in determining the provision for bad debts.
- Recognising liabilities arising from guarantees.
- Recognising revenue from sales of equity investments.
- Recognising income from default compensation.
- Conditions for ceasing the use of the equity method of accounting for an investment.
- Investor accounting when an equity method associate has a prior period adjustment.
- Depreciation of fixed assets that have not yet been put into service or that are taken out of service due to redundancy.
- Depreciation of fixed assets under improvement or major repair.
- Classification of payables relating to acquisition of long-lived assets.
- How to account for a special purpose government grant.
- Balance sheet classification of interest payable on long-term debt.
- Measuring gain on a non-monetary transaction if a tax must be paid.
- Disclosure relating to a subsidiary that is acquired or disposed of during the year and how to account for such subsidiary in consolidated financial statements.
- Disclosures relating to commitments.
- What to do when a local government accounting requirement conflicts with an MOF requirement.

- Whether a change in the method of calculating the bad debt provision is a change in accounting policy or change in estimate.

Early in 2002, MOF issued transitional Q&As for FIEs adopting ASBE.

Accounting System for Not-for-Profit Organisations

In September 2002, the MOF issued for comment an exposure draft of an accounting system for not-for-profit organisations. The system requires these organisations to use accrual accounting (with certain exceptions) and explains how to account for donations of cash and non-cash assets (including unrestricted, temporarily restricted, and permanently restricted donations), grants, income and expense recognition, depreciation, impairment recognition, and financial reporting. Details can be found in the Appendix to this Update.

New CSRC Corporate Governance Requirements for Listed Companies

Independent directors. By 30 June 2002, at least two members of the board of directors of all listed companies in China were required to be independent directors. And by 30 June 2003, at least one third of board are required to be independent directors. At least one of the independent directors should be an accounting professional (refers to personnel with senior professional title or certified public accountants). These rules were established by CSRC in Zhengjianfa [2001] No. 102 issued in August 2001. All domestically listed companies must make necessary amendments to the articles of association to implement these requirements.

Mandatory code of corporate governance. To further strengthen corporate governance on listed companies, in January 2002, CSRC issued new Code of Corporate Governance for Listed Companies (Zhengjianfa [2002] No. 1). The new Code is a set of comprehensive rules covering basic principles for corporate governance of listed companies, the means for the protection of investors' interests, and the ethical requirements for directors, supervisors, managers and other senior management members. In particular, the Code emphasises that listed companies must be operated in an independent manner and sets out the minimum disclosure regarding corporate governance such as (1) the composition of the board of directors and the supervisory board; (2) the performance and evaluation of the board of directors, the supervisory board, and the independent directors; (3) the composition and work of the specialised committees of the board of directors; and (4) specific plans and measures to improve corporate governance.

Disclosures relating to acquisitions. In September 2002, the CSRC issued a regulation regarding the acquisition of a significant holding in a listed company. In November 2002, in support of the earlier regulation, the CSRC issued the following new disclosure rules relating to acquisition of listed companies that are effective from 1 December 2002. These rules are added to the CSRC's Standard for the Form and Content of Information for Disclosure by Companies with Securities Issued to the Public:

- No. 15, Report of Changes in Shareholdings in Listed Companies.
- No. 16, Report for the Acquisition of Listed Companies (30% or less interest).
- No. 17, Offering Report for Acquisitions (greater than 30% interest).
- No. 18, Directors report of acquiree companies.
- No. 19, Offering Report Exemption Application.

Certification of financial statements by executives and other disclosures. In January 2003 the CSRC issued revised guidelines for corporate annual reports and accounts, requiring among other things that managers and financial executives guarantee in writing that the reports and accounts contain no major errors or misleading information. The revised rules also standardise the format of the annual report summary by including a reporting format in an appendix.

Revised CSRC Quarterly Reporting Rules

The CSRC has proposed to revise its guidelines on quarterly reporting. They clarify that quarterly results need not be audited if there are no specific requirements from the CSRC or the stock exchanges. Quarterly reports should include information about significant accounting policy changes, error corrections, and explanations for any changes in the scope of consolidation. Disclosure is also required about changes to any senior executive management positions or controlling shareholders, serious court cases and final rulings, and the total amount of guarantees and cash assets entrusted to other institutions.

Foreign Investors Can Buy Listed “A” Shares

Starting 1 December 2002, certain “qualified foreign institutional investors” have been allowed to purchase “A” shares on Chinese stock exchanges. Prior to then, only Chinese investors were permitted to buy “A” shares. Under the new rules, to be a “qualified foreign institutional investor”, an overseas fund management institution, insurance company, securities company, bank, or other asset management institution must manage at least US\$10 billion in assets and meet certain other criteria. Further, these institutions must receive prior approval by the CSRC to invest in China’s securities market and must be granted an investment quota by the State Administration of Foreign Exchange.

Also, Foreign Investors Can Buy State-Owned Shares

In November 2002, the CSRC, MOF, and the State Economic and Trade Commission, with the approval of the State Council, jointly issued a circular that sets out regulations governing the transfer of state-owned and corporate shares of listed companies to foreign investors. Under the circular, foreign investors are permitted to purchase such shares in certain circumstances. However, shares relating to industries or type of business where foreign investment is forbidden may not be transferred to foreign investors. The circular also specifies that the share transfer should conform to the CSRC regulations on purchase of shares of listed companies.

Comparison of IFRS and PRC GAAP

In the fourth quarter of 2002, Deloitte Touche Tohmatsu published, in both English and Chinese, *GAAP Differences in your Pocket: IAS and GAAP in the People's Republic of China*. This little booklet summarises differences between International Financial Reporting Standards and Chinese GAAP. You can download both versions at www.iasplus.com/links/pubs.htm.

China and International Convergence of Accounting Standards

Madam Feng Shuping, Assistant Minister of Finance with responsibility for the establishment of Chinese Accounting Standards, made a policy presentation titled “Strengthen Co-operation to Promote International Convergence of Accounting Standards” at a meeting of national accounting standard setters that was held in connection with the 16th World Congress of Accountants in Hong Kong in November. Both the text and PowerPoint slides can be downloaded from www.iasplus.com/country/china.htm.

Appendix

Accounting System for Not-for-Profit Organisations

In September, the MOF issued for comment an exposure draft of an accounting system for not-for-profit organisations. A not-for-profit organisation is one that does not have equity owners, that does not operate with an intention of making a profit, and whose assets, on liquidation, can only be used for public interest purposes. Among the issues addressed in the exposure draft are the following:

- In general, not-for-profit organisations should use the accrual basis of accounting.
- Definitions of assets and liabilities are the same as those in the MOF's Accounting System for Business Enterprises.
- Donated assets received should be recognised as income. Donation income should be reported in three categories: (1) unrestricted, (2) temporarily restricted, and (3) permanently restricted.
- In the balance sheet, not-for-profit organisations should report the amounts for each of three classes of net assets – permanently restricted net assets, temporarily restricted net assets, and unrestricted net assets – based on the existence or absence of donor-imposed restrictions. Donated funds for which only interest (but not principal) may be spent should be separately classified.
- Government grants at no consideration should be recognised as income only when received.
- Income from principal activities (those within the scope of the memorandum of association) such as membership fee income and donation income should be recognised when received or earned. Income from other activities (for instance, exhibition income) should be recognised when earned. Other service income should be recognised using the percentage of completion method.
- If a not-for-profit organisation receives assets in exchange for a service provided by the not-for-profit organisation, income should be recognised separately from donation income.
- If a not-for-profit organisation receives assets to be held temporarily on behalf of another party, a liability should be recognised.
- If non-cash assets are received from a donor, the recorded amount of the assets received should be determined in accordance with the following principles, which are similar to the principles in the Chinese Accounting Standard on fixed assets, namely:
 - (1) if the donor has provided supporting documents on the value of the asset, the asset should be recorded at the amount in the supporting documents plus any taxes and charges payable thereon;
 - (2) if the donor has not provided any supporting documents on the value of the asset, the asset should be recorded as follows:
 - a. if an active market exists for the same type of or similar assets, the asset should be recorded at an amount estimated by reference to the market price of the same type of or similar assets, plus any taxes and charges payable thereon;
 - b. if an active market does not exist for the same type of or similar assets but its value can be reliably measured, the asset should be recorded at that amount. Otherwise, the asset should not be recognised in the accounts (though it should be included in the entity's asset records).
 - (3) A used fixed asset obtained through donation should be recorded at an amount for a new item determined by the above methods as reduced by any impairment in value by reference to the condition of the asset.
- A not-for-profit organisation will classify its fixed assets into seven categories:
 - (1) buildings;
 - (2) normal equipment;
 - (3) specialised equipment;

- (4) transportation equipment;
 - (5) show items;
 - (6) books; and
 - (7) other fixed assets.
- Depreciation of fixed assets is required to be provided based on their estimated useful lives and their economic benefits consumption pattern. Category (1) above not less than 20 years. Categories (3), (4), and (5) not less than 10 years. And categories (2), (6), and (7) not less than 5 years.
 - All assets should be reviewed for impairment and, if appropriate, an impairment loss should be recognised.
 - The accounting report of a not-for-profit organisation should include a balance sheet, income and expenditure statement, detailed expenditure statement, cash flow statement, and other supplementary statement(s) that may be specified in MOF regulations.

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