

# **China Financial Reporting Update**

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## **2003 Year-End Review**

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2003 was a year of continued progress in accounting and financial reporting in China. We present below some of the activities of the Ministry of Finance (MOF), the China Securities Regulatory Commission (CSRC), and the Chinese Institute of Certified Public Accountants (CICPA).

### **MOF**

#### ***Accounting System for Business Enterprises***

The Ministry of Finance issued two sets of Q&A in 2003 on the Accounting System for Business Enterprises. One Q&A specifies that all newly formed companies (other than very small ones and financial institutions) must adopt the ASBE. Previously, listed companies, joint stock limited enterprises, and foreign invested enterprises were required to follow the ASBE.

Also, MOF said that all State Owned Enterprises will be required to adopt the accounting system by 2005. Transition guidance for enterprises engaging in normal industries was issued in November 2003 for their implementation of the accounting system.

#### ***Negative goodwill***

One of the Q&A requires that all new negative goodwill (known as “Credit Balance of Equity Investment Differences” in China which is usually calculated based on the carrying amount ascribed to the separable net assets of the equity accounted investee, sometimes at appraisal value, but never based on the fair value) be credited directly to shareholders' equity. Companies may continue to amortise negative goodwill that arose prior to issuance of the circular.

#### ***Consolidation***

In one of the Q&A, the MOF announced that only the following four classes of companies must prepare consolidated financial statements:

- Listed enterprises
- Certain export companies that required to prepare consolidated financial statements
- State asset management enterprises
- Others if specifically required.

In another change to the consolidation rules, a subsidiary may no longer be removed from consolidation based on management's intent to dispose of the subsidiary. It must be consolidated until disposal.

### **Segment information**

Under the same Q&A, the requirement to disclose segment information, initially applicable to all companies that follow the ASBE, has been narrowed, in practice, to listed companies only, basically the same as IAS 14 and US GAAP.

### **Accounting System for Financial Institutions**

The scope of application of this System, which was adopted in 2002 for listed financial institutions and foreign invested financial institutions, has been extended to unlisted non-foreign invested brokerages starting 1 January 2004.

MOF is developing accounting guidance for specific classes of financial institutions:

- Brokerages: Issued November 2003.
- Banks: Expected 2004.

These financial institutions would follow both the existing Accounting System for Financial Institutions and the guidance for their specific type of financial institution.

### **Events after the balance sheet date**

In April 2003, the Ministry of Finance amended its standard on events after the balance sheet date to conform to International Accounting Standard 10. The biggest change is to prohibit recognition of a liability, at the balance sheet date, for dividends declared after that date but before the financial statements have been approved for issue. The changes are effective 1 July 2003.

### **Hook-up fees**

The MOF has issued guidance on accounting for hook-up fees – nonrefundable up-front connection fees received by telephone, electric, gas, cable t.v., and similar public utilities. Such fees cannot be recognised as revenue up front but, rather, must be amortised over the contract or other expected period of benefit to the company.

### **Outstanding Exposure Drafts at Year end**

- Presentation of financial statements.
- Earnings per share.
- Discontinuing operations.
- Government grants and assistance.
- Foreign currency translation.
- Segment reporting.

### **Accounting System for Not-for-Profit Organisations**

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.

## CSRC

### ***Annual reports of listed companies***

In January 2003 the CSRC revised its Form and Content Standard No. 2 for corporate annual reports and accounts (effective for 2002 financial reports) to require, among other things that managers and financial executives guarantee in writing that the information contained in the financial reports is true and complete. This requirement is subsequently extended to quarterly and half-yearly reports. The revised rules also standardise the format of the annual report summary by including a reporting format in an appendix.

CSRC revised the Form and Content Standard No. 2 again in December 2003 (effective for 2003 financial reports). There are no significant changes in financial reporting, but the rules require additional disclosure in the annual report relating to the use of the funds of the listed companies by controlling shareholders and related parties and also provision of financial guarantees to these parties.

### ***Interim reports of listed companies***

In March 2003, the CSRC changed its guidelines on quarterly reporting by requiring additional disclosure of total number of shareholders at the end of the quarter and also the preparation of accounting statement (not include notes) in accordance with accounting standards for interim reporting.

In June 2003, the CSRC revised its guideline on half-yearly reporting. The revised guidelines specify that the half-yearly reports should be prepared in accordance with accounting standards for interim reporting.

### ***Auditor Rotation***

The CSRC has adopted a new auditor rotation requirement. After five years, an individual CPA who signs an audit report and the person in charge of the audit must rotate off audit of a listed company. For an IPO company, those persons must rotate off in the third year after the IPO. These are requirements for rotation of people, not firms. The rule is effective 2004.

## CICPA

The Technical Expert Team of the Chinese Institute of CPAs, has issued two accounting related Guidance Bulletins:

**Bulletin #6** (4 August 2003) addresses:

- Whether to make appraisal value adjustment on conversion of debt into equity.
- Accounting for tree planting.
- Accounting for ancillary costs of issuing convertible bonds – property development industry.
- Auditing of shipping companies that own foreign-registered ships.
- Accounting for expenses incurred for debt restructurings.

**Bulletin #7** (5 December 2003) addresses:

- Income tax relating to upward revaluation of assets in transformation of the form of an enterprise.
- Application of the definition of cash and cash equivalents.
- Classification of rights to collect highway tolls and accounting for subsequent expenditures incurred.
- Injection of land use rights as capital – can it be regarded as cash injection of capital.
- Accounting for investments in schools.
- Capital verification for private schools.
- How to account for ‘asset swaps’ of an entire business with unrelated parties.

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