Accounting System for Business Enterprises

(applicable to Joint Stock Limited Enterprises effective 1 January 2001 and applicable to Foreign Investment Enterprises effective 1 January 2002)

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Chapter 1: General Provisions

Article 1

In accordance with "The Accounting Law of the People's Republic of China" and other related laws and regulations promulgated by the State, the Accounting System for Business Enterprises (the "Accounting System") is formulated to prescribe accounting treatments by enterprises and to ensure true and complete accounting information is provided by enterprises.

Article 2

This Accounting System is applicable to all enterprises (including companies) established within the People's Republic of China (the "PRC"), except for enterprises with a small scale of operation and which do not raise funds externally, and financial and insurance enterprises.

Article 3

An enterprise should adopt a set of accounting policies and methods suitable for the enterprise in accordance with the requirements of the relevant accounting laws, administrative regulations, and in the light of the specific circumstances of the enterprise, provided that this Accounting System is not violated.

Article 4

An enterprise should prepare accounting vouchers and accounting ledgers, and manage accounting files and records in accordance with the requirements of "The Accounting Law of the People's Republic of China", "Basic Accounting Practice Regulations" and "Rules on Accounting Files and Records Management".

Article 5

An enterprise should account for all the transactions and events undertaken by the enterprise so as to properly record and reflect its production and operating activities for accounting purposes.

Article 6

It should be presumed for accounting purposes that the enterprise is a continuing entity and will remain in normal production and operating activities in the foreseeable future.

Article 7

An enterprise should close the accounts and prepare financial and accounting reports for separate accounting periods. Accounting periods comprise a full year, a half-year, a quarter or a month, each of which must be determined based on the Gregorian calendar. A half-year, a quarter or a month is also referred to as an interim period.

The term "end of a period" (or "periodically") used in this Accounting System may refer to the end of a month, a quarter, a half-year or a full year.

Article 8

An enterprise should use Renminbi (RMB) as the recording currency for accounting purposes, except as follows:

A foreign currency can be used as the recording currency if the enterprise's transactions are mainly dominated in foreign currencies. However, the foreign currency books of accounts should be translated to RMB in preparing financial and accounting reports.

A Chinese enterprise established aboard should translate the financial and accounting reports into RMB for PRC reporting purposes.

Article 9

The double entry (i.e. debit and credit) bookkeeping system should be adopted.

Article 10

Accounting records should be compiled in Chinese. Enterprises in autonomous regions may additionally use a minority language commonly adopted in the region. Foreign investment enterprises, foreign enterp rises and other foreign organizations within the PRC may additionally use a foreign language for compilation of accounting records.

Article 11

An enterprise should comply with the following basic principles for accounting purposes:

(1) Accounting inform ation should be prepared on the basis of the transactions and events that have actually occurred and should truly reflect the financial position, operating results and cash flows of the enterprise.

(2) An enterprise should account for transactions and events according to their economic substance and should not merely refer to their legal form.

(3) Accounting information provided by an enterprise should be capable of reflecting the financial position, operating results and cash flows of the enterprise in order to meet the needs of accounting information users.

(4) An enterprise should apply accounting treatments *[Translator note: an accounting treatment here refers to an accounting policy chosen when two or more practices are acceptable]* consistently throughout different accounting periods. Accounting treatments should not be changed arbitrarily. Where changes are necessary, the details and reasons of the change, the amount of the cumulative effect of the change, or the reason that the cumulative effect of the change cannot be reasonably determined, should be disclosed in the notes to the accounting statements.

(5) An enterprise's accounting should comply with prescribed accounting treatments. Accounting information [including key figures and ratios] should be comparable, and prepared on consistent bases.

(6) Accounting information should be prepared in a timely manner and should not be prepared in advance or delayed.

(7) Accounting information and financial and accounting reports should be prepared in a clear and concise manner, so that it can be readily understood and used.

(8) Accounting information should be prepared on an accrual basis. All revenue realized and expenses incurred or attributable to the current period should be recognized as income or expenses in the current period whether or not the amounts are received or paid. Revenue and expenses not attributable to the current period should not be recognized as income or expenses in the current period even if the amounts are received or paid in the current period.

(9) Revenue should be matched against related costs and expenses for accounting purposes. Revenue and related costs and expenses attributable to the same accounting period should all be recognized in that period.

(10) Assets should be recorded at the actual costs at the time of acquisition. If an asset is impaired subsequently, an enterprise should make a corresponding provision for impairment loss in accordance with this Accounting System. Except as stipulated by laws, administrative regulations or the unified accounting system promulgated by the State, an enterprise must not adjust the carrying amounts of assets.

(11) An enterprise should reasonably classify expenditures as revenue in nature or capital in nature. If all the benefits arising from an expenditure are realized within the current period (or an operating cycle), the expenditure should be classified as revenue in nature. If the benefits arising from an expenditure are realized over several accounting periods (or several operating cycles), the expenditure should be classified as capital in nature.

(12) An enterprise should comply with the requirements of the prudence concept for accounting purposes. An enterprise should not overstate assets or revenue, or understate liabilities or expenses. However, it should not provide for any hidden reserve.

(13) An enterprise should comply with the requirements of the materiality concept for accounting purposes. An enterprise should assess the materiality of transactions or events in the process of accounting to determine the manner in which they should be accounted for. Material events (that is, events with significant impact on assets, liabilities or profit or loss that would affect the users of a financial and accounting report in making reasonable judgments on the basis of the report) should be accounted for in accordance with prescribed accounting treatments and procedures, and disclosed in the financial and accounting reports adequately and accurately. In relation to less material accounting events, the accounting treatments may be suitably simplified on the condition that this will not affect the faithful representation of the accounting information and will not mislead the users of financial and accounting reports in forming a proper judgment.

Chapter 2: Assets

Article 12

An asset is a resource that is (a) owned or controlled by an enterprise as a result of past transactions or events and (b) expected to generate economic benefits to the enterprise.

Article 13

Assets of an enterprise should be classified into current assets, long-term investments, fixed assets, intangible assets and other assets according to their liquidity.

Section 1 Current Assets

Article 14

Current assets are assets that will be realized or consumed within one year or within an operating cycle that is longer than one year. Current assets include cash, bank deposits, short-term investments, accounts receivable, prepayments, deferred expenses and inventories.

Under this Accounting System, an investment is an asset obtained by an enterprise, through the transfer of another asset to other enterprises, for the accretion of wealth through distribution or for obtaining other gains.

Article 15

An enterprise should prepare daily journals for cash and bank deposits and record each transaction on a daily basis in chronological order. Bank deposits should be separately recorded according to the names of the individual banks and financial institutions and the types of the deposits.

An enterprise should account for cash and deposits in foreign currencies and those in RMB separately.

The book balance of cash must equal to the physical amount kept by the enterprise. Bank statements should be reconciled to the book balances of bank deposits periodically, with bank reconciliation statements prepared monthly.

Under this Accounting System, book balance is the actual account balance stated in a ledger account, without deducting the corresponding provisions (such as accumulated depreciation, provision for impairment loss on relevant assets).

Article 16

Current investments are investments that are readily realizable and are intended to be held for not more than one year (including one year), including shares, bonds and investment funds. Current investments should be accounted for in accordance with the following principles:

(1) A current investment should be recorded at investment cost on acquisition. The investment cost of a current investment should be determined according to the following principles:

1. For a current investment acquired for cash, the investment cost should be the actual total price paid, including incidental expenses such as tax payments and handling charges. Cash dividends declared but unpaid, or bond interest due but unpaid, that are included in the price paid should be accounted for separately and do not form part of the investment cost.

   Cash deposited in a securities company that has not yet been invested in current investments should initially be recorded as "other monetary funds". After the funds have been invested, the cost of the current investment should be recorded at the actual price paid, or at the actual price paid less any cash dividends declared but unpaid, or bond interest due but unpaid.

2. For a current investment received as a capital contribution by an investor, the cost of the current investment should be the value agreed by all investing parties.

3. For a current investment obtained by way of accepting non-cash assets from a debtor to satisfy a debt, or by exchanging (with another party) a debt receivable for a current investment, the cost of investment should be the carrying amount of the debt receivable plus any relevant tax payments arising. If the current investment received includes cash dividends declared but unpaid, or bond interest due but unpaid, the cost of investment should be the carrying amount of the debt receivable less the dividends or interest receivable plus any relevant tax payments. When boot is involved, the cost of the current investment obtained should be determined as follows:

   (i) When boot is received, the cost of the current investment should be recorded at the carrying amount of the debt receivable less the boot received, plus any relevant tax payments.

   (ii) When boot is paid, the cost of the current investment should be recorded at the carrying amount of the debt receivable plus the boot paid and any relevant tax payments.

   Under the Accounting System, carrying amount is the net amount of the book balance of an account after deducting relevant provisions. For example, the carrying amount of "current investments" is the book value of current investments net of any provision for decline in value.

4. For a current investment received in a non-monetary transaction, the cost should be the carrying amount of the asset surrendered plus any relevant tax payments. When boot is involved, the cost of the current investment received should be determined as follows:

   (i) When boot is received, the cost of the current investment is recorded at the carrying amount of the assets surrendered plus any profit that should be recognized as a result of receiving the boot and any relevant tax payments, less the boot received.

   (ii) When boot is paid, the cost of the current investment is recorded at the carrying amount of the assets surrendered plus any relevant tax payments and the boot paid.

(2) Cash dividends or interest on a current investment, other than those already recorded as "dividends receivable" or "interests receivable", should offset against the carrying amount of the investment upon receipt.

(3) Current investments should be measured at the lower of cost and market value at the end of a period. A provision for decline in value of current investments should be made for the shortfall of market value below cost.

Provision for decline in value of current investments should be accounted for separately. In the balance sheet, current investments should be presented at an amount net of provision for decline in value.

(4) On disposal of a current investment, the difference between the carrying amount and the actual price received for the current investment should be recognized as an investment gain or loss for the current period.

Indirect loans to others by an enterprise *[Translator note: Indirect loans are loans made by the enterprise to a borrower via an authorized lending institution]* should be accounted for as current investments. Interest income from such loans should be accrued on a periodic basis and recognized in the income statement. An enterprise should stop accruing interest if that interest cannot be collected on interest payment dates, and any interest that has previously been accrued should be reversed. At the end of a period, an enterprise should make a provision for impairment loss on such loans in accordance with the requirements for recognizing impairment loss on assets.

Article 17

Accounts receivable and prepayments are those arising from the ordinary course of operations of an enterprise, including accounts receivable (such as notes receivable, accounts receivable and other receivables) and prepayments.

Article 18

Accounts receivable and prepayments should be accounted for according to the following principles:

(1) Accounts receivable and prepayments should be recorded at the actual amounts. They should be accounted for in the sub-ledger accounts according to the names of the debtors.

(2) For interest bearing accounts receivable, the book balance should be increased at the end of a period by an interest amount calculated on the basis of the principal (or face value) outstanding and the prescribed interest rate. Interest income should be recognized as income for the current period.

(3) For notes receivable that cannot be collected on maturity, the book balance should be transferred to accounts receivable. Interest should no longer be accrued.

(4) An enterprise accounts for a receivable that is settled through a debt restructuring arrangement according to the following requirements:

(i) Where a receivable is settled by cash at an amount lower than the carrying amount of the receivable, the difference between the carrying amount of the receivable and the actual amount received by the enterprise should be recognized as an non-operating expense for the current period.

(ii) Where a receivable is settled by a transfer of non-cash assets, the enterprise should record the non-cash assets received at an amount equal to the carrying amount of the receivable restructured.

If several non-cash assets are received, each non-cash asset received should be recognized by allocating the carrying amount of the receivable according to the proportion of the fair value of the individual non-cash assets over the total fair value of all non-cash assets received.

(iii) Where a receivable is converted into equity interest in the debtor, the enterprise should recognize the equity interest received at the carrying amount of the receivable.

If several types of equity interest are involved, each type of equity interest received should be recognized by allocating the carrying amount of the receivable according to the proportion of the fair value of the individual equity interests over the total fair value of all equity interests received.

(iv) Where the settlement of a receivable involves the modification of terms and the total amount of the future receipts is lower than the carrying amount of the receivable restructured, the difference should be recognized as a non-operating expense for the current period. Where the modified terms involve contingent receipts, the contingent receipts should not be recognized as a receivable. Such contingent receipts should be recognized as non-operating income in the period they are actually received.

Where the total amount of the future receipts is equal to or greater than the carrying amount of the receivable restructured, no accounting entry should be made at the time of debt restructuring. However the difference should be recorded in the enterprise's memorandum records. Receivables after modification of terms are accounted for according to the accounting treatments stipulated in this Accounting System in respect of accounts receivable in general.

Under this Accounting System, a debt restructuring is an event in which the terms of a debt are modified as a result of a mutual agreement between a debtor and a creditor or a judgment by a court. Contingent receipts are receipts that are dependent on the occurrence of specified future events, the occurrence of which is uncertain.

(5) Provision for bad debts should be made at the end of each period on accounts receivable (excluding notes receivable).

Provision for bad debts should be accounted for separately. In the balance sheet, accounts receivable (excluding notes receivable) should be presented at an amount net of provision for bad debts.

Chapter 2: Assets

Article 19

Deferred expenses are expenses paid by the enterprise that should be expensed over the current and subsequent periods *[Translator note: "periods" in this Article means accounting periods less than a full year, for example monthly or quarterly periods]*, for which the amortization period is one year or shorter. Deferred expenses include low-value consumables, prepaid insurance, a lump-sum payment for a stamp duty certificate and a large lump-sum payment of stamp duty that should be amortized.

Deferred expenses should be amortized and recognized as costs or expenses evenly over the beneficial periods (within one year). If deferred expenses are unable to generate any benefit to an enterprise, the unamortized balance should be written off as costs or expenses for the current period, and should no longer be deferred.

Deferred expenses should be accounted for separately in the sub-ledger accounts according to the different types of expenses.

Article 20

Inventories are assets held by an enterprise for sale in the ordinary course of business, or in the process of production, or in the form of materials or supplies to be consumed in the production process or in the rendering of services, including materials, merchandise, work in progress, semi-finished goods, and finished goods. Inventories should be accounted according to the following principles:

(1) Inventories should be recorded at actual cost on acquisition. Actual cost should be determined as follows:

(i) For purchased inventories, the actual cost should comprise the purchase price, transport, handling, insurance, packing and warehouse costs *[Translator note: typically referring to pre-delivery warehouse costs]*, reasonable wastage incurred during transportation, handling and sorting costs before storage, and any prescribed taxes and expenses.

For inventories purchased by commodities distribution enterprises, the actual cost should comprise the purchase price plus any prescribed taxes. Transport, handling, insurance, packing and warehouse costs incurred in the acquisition of inventories, reasonable wastage incurred during transportation, handling and sorting costs incurred before storage are recognized directly in the income statement.

(ii) For self-produced inventories, the actual cost should be the actual expenditures incurred in the production process.

(iii) For inventories produced by subcontractors, the actual cost should comprise costs of raw materials and semi-finished products actually consumed, plus costs of conversion, transport, handling and insurance costs, and any prescribed taxes.

For inventories processed by commodities distribution enterprises, the actual cost should comprise the purchase price, conversion costs and any prescribed taxes.

(iv) For inventories received as a capital contribution by an investor, the actual cost should be the value agreed by all investing parties.

(v) For inventories obtained through donation, the actual cost should be determined as follows:

(a) if the donor has provided supporting documents (such as invoice, customs declaration or relevant agreement) on the value of the inventories, the actual cost should be determined in accordance with the amount on those supporting documents, plus any relevant tax payments.

(b) if the donor has not provided any supporting documents on the value of the inventories, the actual cost of inventories should be determined as follows:

- if an active market exists for the same or similar type of inventories, the actual cost should be estimated by reference to the market price of the same or similar type of inventories, plus any relevant tax payments.

- if no active market exists for the same or similar type of inventories, the actual cost should be the present value of future cash flows of the donated inventories.

(vi) For inventories obtained by accepting non-cash assets from a debtor to satisfy a debt, or by exchanging (with another party) a debt receivable for inventories, the actual cost of such inventories obtained should be the carrying amount of the debt receivable less any deductible input value added tax, plus any relevant tax payments. When boot is involved, the actual cost of the inventories obtained should be determined as follows:

(a) When boot is received, the actual cost should be the carrying amount of the debt receivable less any deductible input value added tax and the boot, plus any relevant tax payments.

(b) When boot is paid, the actual cost should be the carrying amount of the debt receivable less any deductible input value added tax, plus the boot paid and any relevant tax payments.

(vii) For inventories received in a non-monetary transaction, the actual cost should be the carrying amount of the asset surrendered, less any deductible input value added tax, plus any relevant tax payments. When boot is involved, the actual cost of the inventories received should be determined as follows:

(1) When boot is received, the actual cost should be the carrying amount of the asset surrendered, less any deductible input value added tax and the boot received, plus any profit to be recognized and any relevant tax payments.

(2) When boot is paid, the actual cost should be the carrying amount of the asset surrendered, less any deductible input value added tax, plus any relevant tax payments and the boot paid.

(viii) For excess inventories identified in a stock-take, the actual cost should be determined based on the market price of the same or similar type of inventories.

(2) For an enterprise that adopts the standard costing method (or selling price method) to account for inventories, the variances between standard costs and actual costs should be separately accounted for.

(3) In determining the cost of inventories transferred out or issued for use, the actual costs should be determined by first-in first-out, weighted average, moving average, specific identification or last-in first-out method. If the standard costing method is used, cost variances should be computed periodically to adjust standard costs to actual costs.

Low value consumable stores and packaging and other re-usable materials should either be written off in full when issued for use or amortized based on the number of times that they are expected to be used.

(4) Stock-taking should be performed periodically, at least once annually. If the stock-take results do not agree with the accounting records, the enterprise should investigate the reasons before the end of the period. Such stock-take discrepancies should be resolved and approved in a shareholders' meeting or directors' meeting, or managers'/factory managers' meeting or by other similar bodies (according to the management authority set-up in the enterprise) before closing the accounts at the period end. Excess inventories identified in a stock-take should be used to reduce administration expenses in the current period. Deficits of inventories should be charged as administration expenses in the current period after deducting any compensation from the responsible individuals or insurance companies and the scrap value. Any abnormal loss should be recorded as non-operating expenses.

If approval is not obtained for excess inventories or deficits of inventories before closing of accounts, an enterprise should adjust these discrepancies in the financial reports in accordance with the above accounting treatments and state in the notes to the accounting statements that such adjustments have not been approved. If the amount approved subsequently is different, the difference should be adjusted to the opening balances of relevant accounting statements items.

(5) Inventories of an enterprise should be measured at the lower of cost and net realizable value at the end of a period. Where the net realizable value is lower than the cost, the difference should be recognized as provision for decline in value.

In the balance sheet, inventories should be reported at an amount net of provision for decline in value.

Section 2 Long-term investments

Article 21

Long-term investments are investments other than current investments, including equity investments, bonds not readily realizable or not intended to be realized shortly, other debt investments and other long-term investments, all of which are intended to be held for more than one year (not including one year).

Long-term investments should be accounted for separately and presented as a separate item in the balance sheet.

Article 22

Long-term equity investments should be accounted for according to the following principles:

(1) A long-term equity investment should be recorded at its initial investment cost on acquisition. The initial investment cost should be determined as follows:

1. For a long-term equity investment acquired by cash, the initial investment cost should be the actual total price paid, including incidental expenses such as tax payments and handling charges. If the price paid includes cash dividends declared but unpaid, the initial investment cost should be the actual price paid less any cash dividends declared but unpaid.

2. For a long-term equity investment obtained by accepting non-cash assets from a debtor to satisfy a debt, or by exchanging (with another party) a debt receivable for a long-term investment, the initial investment cost should be the carrying amount of the debt receivable plus any relevant tax payments. When boot is involved, the initial investment cost of the long-term equity investment should be determined as follows:

   (i) When boot is received, the initial investment cost is the carrying amount of the debt receivable less the boot plus any relevant tax payments.

   (ii) When boot is paid, the initial investment cost is the carrying amount of the debt receivable plus the boot and any relevant tax payments.

3. For a long-term equity investment received in a non-monetary transaction, the initial investment cost should be the carrying amount of the assets surrendered plus any relevant tax payments. When boot is involved, the initial investment cost of the long-term equity investment should be determined as follows:

   (i) When boot is received, the initial investment cost should be the carrying amount of the assets surrendered plus any profit that should be recognized and any relevant tax payments, less the boot received.

(ii) When boot is paid, the initial investment cost should be the carrying amount of the assets surrendered plus any relevant tax payments and the boot paid.

4. For a long-term equity investment acquired through an administrative transfer *[Translator note: typically referring to a transfer of assets, usually to a state-owned enterprise, from the government ministry or unit to which the reporting enterprise belongs]* should be the carrying amount of the investment in the books of the transferor.

(2) Long-term equity investments should be accounted for using either the cost method or the equity method as appropriate in the circumstances. The cost method should be used when an enterprise does not have control, joint control or significant influence over the investee enterprise. The equity method should be used when an enterprise has control, joint control or significant influence over the investee enterprise. In general, where the investing enterprise holds 20% or more of the voting shares of the investee enterprise, or where it holds less than 20% of the voting shares of the investee enterprise but has significant influence over the investee enterprise, it should adopt the equity method. When the investing enterprise holds less than 20% of the voting shares of the investee enterprise, or where it holds 20% or more of the voting shares of the investee enterprise but does not have significant influence over the investee enterprise, it should use the cost method.

(3) When the cost method is adopted, the carrying amount of a long-term equity investment should normally remain unchanged, unless additional investment is made, or cash dividends or profits distributed are re-invested into the investee enterprise, or the investment is recouped. Profits or cash dividends declared by the investee enterprise should be recognized as investment income for the current period. The amount of investment income recognized by the investing enterprise should be limited to the amount distributed out of accumulated net profits of the investee enterprise that arose after the investment was made. The amount of profits or cash dividends declared by the investee enterprise in excess of the above threshold should be treated as return of investment cost, and therefore the carrying amount of the investment should be reduced accordingly.

(4) When the equity method is adopted, the investment should initially be measured at the initial investment cost. The difference between the initial investment cost and the investor's share of owners' equity of the investee enterprise is referred to as "equity investment difference" and should be amortized evenly over a defined period and charged to the income statement accordingly.

The equity investment difference should be amortized over the "investment period", if this is stipulated in the investment contract. If an investment period is not stipulated in the contract:

- an excess of the initial investment cost over the investor's share of owners' equity of the investee enterprise should be amortized over a period of not more than 10 years;
- a shortfall of the initial investment cost over the investor's share of owners' equity of the investee enterprise should be amortized over a period of not less than 10 years.

When the equity method is adopted, the investing enterprise should, after the acquisition of the equity investment, adjust the carrying amount of the investment according to its share of the investee enterprise's net profit or loss (with the exception of net profits which do not belong to the investing enterprise according to laws, regulations or the articles of association, such as the profit paid to the operator of the investee enterprise under a subcontracting agreement [that is the investing enterprise contract out the operation of the investee enterprise to an operator who in return gets a share of profit of the investee enterprise], and the staff incentive and welfare fund set aside at a stipulated proportion of the profit and accounted for as liabilities by a foreign investment enterprise) and recognize investment income for the current period accordingly. The investing enterprise should reduce the carrying amount of investments by its share of the investee enterprise's profit distribution or cash dividends declared. An enterprise recognizes net losses incurred by the investee enterprise to the extent that the carrying amount of the investment is reduced to zero. If the investee enterprise realizes net profits in subsequent periods, the investing enterprise should increase the carrying amount of the investment above zero at the amount at which its share of profits exceeds its share of previously unrecognized losses.

The adjustment to the carrying amount of investment and the recognition of the investment gain or loss under the equity method should be based on the net profit or loss of the investee enterprise that arises after the investment was made.

The carrying amount of investment should also be adjusted for other changes in the owner's equity (other than net profit or loss) of the investee enterprise according to the particular circumstances.

(5) Where the investing enterprise changes the method of accounting for a long term investment from the cost method to the equity method (for example, due to additional investment made), the initial investment cost under the equity method should be the carrying amount of the investment at the time when control, joint control, or significant influence is actually obtained. The difference between this initial investment cost and the share of owners' equity of the investee enterprise should be regarded as an equity investment difference and amortized in accordance with the requirements of this Accounting System, and charged to the income statement accordingly.

When an enterprise no longer has control, joint control or significant influence over the investee enterprise as a result of a reduction of its investment or other reasons, the enterprise should discontinue the use of equity method and adopt the cost method. The carrying amount of the investment should be regarded as the new cost of the investment. Subsequently, if the investee enterprise declares the distribution of profits or cash dividends, the portion that relates to the amount recorded in the carrying amount of the investment should be regarded as a recovery of the new investment cost, and reduces the carrying amount of the investment accordingly.

(6) When an enterprise changes its intention of holding a current investment and reclassifies it as a long-term investment, the transfer should be made at the lower of cost and market value of the current investment. This transfer value should be regarded as the initial cost of the long-term investment. When a long-term investment is intended to be disposed of, it should not be re-classified as a current investment. On disposal, it should be accounted for as disposal of a long-term investment.

(7) On disposal of an equity investment, the difference between the carrying amount of the investment and the sale proceeds actually received should be recognized as an investment gain or loss for the current period.

Article 23

Long-term debt investments should be accounted for according to the following principles:

(1) A long-term debt investment should be recorded at its actual cost on acquisition as the initial investment cost. The initial investment cost should be determined as follows:

1. For a long-term debt investment acquired by cash, the initial cost should be the actual total price paid (including incidental expenses such as tax payments and handling charges) less any interest receivable due but unpaid. If the amounts of incidental expenses such as tax payments and handling charges are insignificant, they can be charged as financial expenses in the current period instead.

2. For a long-term debt investment obtained by accepting non-cash assets from a debtor to satisfy a debt, or by exchanging (with another party) a debt receivable for a long-term debt investment, the initial investment cost should be the carrying amount of the debt receivable plus any relevant tax payments. When boot is involved, the initial investment cost of the long-term debt investment should be determined as follows:

   (i) When boot is received, the initial investment cost should be the carrying amount of the debt receivable less the boot plus any relevant tax payments.

   (ii) When boot is paid, the initial investment cost should be the carrying amount of the debt receivable plus the boot and any relevant tax payments.

3. For a long-term debt investment received in a non-monetary transaction, the initial investment cost should be the carrying amount of the assets surrendered plus any relevant tax payments. When boot is involved, the initial investment cost of the long-term debt investment should be determined as follows:

   (i) When boot is received, the initial investment cost should be the carrying amount of the assets surrendered plus any profit that should be recognized and any relevant tax payments, less the boot received.

   (ii) When boot is paid, the initial investment cost should be the carrying amount of the assets surrendered plus any relevant tax payments and the boot paid.

(2) Interest income on long-term debt investments should be calculated periodically according to the face value of the investment and the coupon rate and recognized as income.

The difference between the initial investment cost of a long-term bond investment (as reduced by any bond interest due but unpaid and accrued bond interest and any related taxes included therein) and the par value of the bond should be treated as investment premium or discount. The premium or discount should be amortized over the period between the acquisition date and the maturity date in which the relevant bond interest is recognized as income. The amortization method used should be either the straight-line method or the effective-interest-rate method.

(3) Convertible bonds held by an enterprise should be treated as ordinary bond investments before conversion to equity. When an enterprise excises the right of conversion and converts a bond into equity investment, the initial investment cost of such equity investment should be the carrying amount of the bond after deducting any cash received.

(4) On disposal of a long-term debt investment, the difference between the carrying amount of the investment and the sale proceeds actually received should be recognized as an investment gain or loss for the current period.

Article 24

Long-term investments should be recorded at the lower of the carrying amount and recoverable amount at the end of each period. Where the recoverable amount is lower than the carrying amount, the difference should be recognized as provision for impairment loss on long-term investments.

In the balance sheet, long-term investments should be presented at an amount net of provision for impairment loss.

Chapter 2: Assets

Section 3 Fixed Assets

Article 25

Fixed assets are assets held by an enterprise that have useful lives of more than one year, including properties, buildings, machinery, equipment, transportation vehicles, and other equipment, utensils and tools used in production and operating activities. Items that have a unit price over RMB 2,000 and have useful lives of more than one year should also be treated as fixed assets, even if they are not directly used in production and operating activities.

Article 26

An enterprise should, based on the definition of fixed assets and the specific circumstances of the enterprise, formulate a set of accounting policies for fixed assets that are suitable to the enterprise, including categories of fixed assets, classification methods, useful lives and depreciation methods for individual fixed assets or categories of fixed assets.

An enterprise should prepare a memorandum comprising a category of fixed assets, classification methods, useful lives, estimated residual values *[Translator note: typically as a percentage of costs]* and depreciation methods for each category of fixed assets or each item of fixed asset *[Translator note: if the asset does not belong to any category]*. The memorandum should be approved in a shareholders' meeting or board of directors' meeting, managers'/factory managers' meeting or a meeting of other similar bodies (according to the management authority set-up in the enterprise). A copy of the memorandum should be sent to relevant parties in accordance with the laws and administrative regulations and a copy should be kept in the office of the enterprise for inspection by relevant parties (including investors). After the memorandum is approved and filed, the above information contained therein should not be changed without reasons. If a change is necessary, the change should only be made in accordance with the above approval and filing procedures and should be stated in the notes to the accounting statements.

Tools and utensils that are not treated as fixed assets should be accounted for as low-value consumable stores.

Article 27

Fixed assets should be recorded at cost on acquisition. The acquisition cost of a fixed asset comprises the purchase price, import duties, transport and insurance costs, and any expenditure necessarily incurred for bringing the fixed asset to working condition for its intended use. The acquisition cost of fixed assets should be determined as follows:

(1) A purchased fixed asset that can be put into use without further construction work should be recorded at the total amount of the actual price, packing, transport and installation costs and any relevant tax payments.

Any input value added tax rebate a foreign investment enterprise received from the tax bureau for purchasing domestic equipment should reduce the cost of the fixed asset.

(2) A self-constructed fixed asset should be recorded at the total amount of all expenditure incurred for bringing the asset to working condition for its intended use.

(3) A fixed asset received as a capital contribution by an investor should be recorded at an amount agreed by all investing parties.

(4) A fixed asset acquired under a finance lease should be recorded at an amount equal to the lower of the original carrying amount of the leased asset *[Translator note: as recorded in the books of the lessor]* and the present value of the minimum lease payments at the inception of a lease.

"Minimum lease payments" in this Accounting System refers to the payments over the lease term that the enterprise (the lessee) should, or may be required to make (excluding contingent rent and execution costs), together with any residual value guaranteed by the enterprise (the lessee) or a party related to the enterprise. However, if the enterprise (the lessee) has an option to purchase the leased asset at a price which is expected to be sufficiently lower than the fair value at the date the option becomes exercisable such that, at the inception of the lease, it is reasonably certain that the option will be exercised, the payment required to exercise this purchase option should be included in the minimum lease payments. Residual value of a fixed asset refers to the fair value of the leased asset at the end of the lease term, as estimated at the inception of the lease.

In calculating the present value of the minimum lease payments an enterprise (the lessee) should use the lessor's interest rate implicit in the lease as the discount rate, if this is known to the lessee. Otherwise, the discount rate should be the interest rate specified in the lease agreement. If both the lessor's interest rate implicit in the lease and the interest rate specified in the lease agreement cannot be determined, the enterprise's (the lessee's) bank borrowing rate for a period equal to the lease term should be used as the discount rate.

If assets leased under finance leases account for 30% or less of the total assets of the enterprise, the leased assets may be recorded at the minimum lease payments at the inception of the lease.

(5) A fixed asset that undergoes modification and enhancement should be recorded at the original carrying amount of the fixed asset plus any expenditure necessarily incurred for bringing the fixed asset to working condition for its intended use (after the modification and enhancement) less any incidental income arising in the course of the modification and enhancement.

(6) For a fixed asset obtained by accepting non-cash assets from a debtor to satisfy a debt, or by exchanging (with another party) a debt receivable for a fixed asset, the fixed asset should be recorded at the carrying amount of the debt receivable plus any relevant tax payments. When boot is involved, the fixed asset should be recorded according to the following:

1. When boot is received, the fixed asset should be recorded at the carrying amount of the debt receivable less the boot plus any relevant tax payments.

2. When boot is paid, the fixed asset should be recorded at the carrying amount of the debt receivable plus the boot and any relevant tax payments.

(7) A fixed asset received in a non-monetary transaction should be recorded at the carrying amount of the assets surrendered plus any relevant tax payments. When boot is involved, the fixed asset should be recorded at an amount determined as follows:

1. When boot is received, the fixed asset should be recorded at the carrying amount of the assets surrendered plus any profit that should be recognized (as a result of receiving the boot) and any relevant tax payments less the boot.

2. When boot is paid, the fixed asset should be recorded at the carrying amount of the assets surrendered plus any relevant tax payments and the boot.

(8) A fixed asset obtained through donation should be recorded at an amount determined as follows:

1. if the donor has provided supporting documents, it should be recorded at the amount stated on those supporting documents, plus any relevant tax payments.

2. if the donor has not provided any supporting documents, the asset should be recorded at an amount determined as follows:

   (a) if an active market exists for the same or similar type of fixed assets, the cost should be estimated by reference to the market price of the same or similar type of fixed assets, plus any relevant tax payments.

   (b) if no active market exists for the same or similar type of fixed assets, the cost should be the present value of expected future cash flows of the donated fixed asset.

3. An old fixed asset obtained through donation should be recorded at an amount determined by the above methods as reduced by the estimated deterioration of the fixed asset based on its conditions.

(9) Any excess fixed asset identified in a fixed asset count should be recorded at an amount determined by reference to the market price of the same or similar type of fixed assets as reduced by the estimated deterioration based on its conditions.

(10) A fixed asset transferred in at nil consideration should be recorded at the carrying amount of the fixed asset in the book of the transferor plus relevant expenses such as transport and installation expenses.

The cost of fixed assets should also include tax payments arising from the acquisition of fixed assets such as contract stamp duties, tax for use of farmland and tax on purchase of vehicles.

Article 28

The actual cost of materials for "construction in progress" *[Translator note: "Construction in progress" is a separate item on the balance sheet, reflecting fixed assets under construction]* should include the actual purchase price paid, VAT, transport, insurance and other related expenses. Each category of materials should be accounted for separately.

Unused materials that are transferred to inventory on completion of construction should be transferred at actual cost or standard cost. If input VAT can be offset, such materials should be transferred to inventory at actual cost or standard cost after deducting input VAT.

The cost of any surplus/deficit/scrapped/damaged construction materials identified, after deducting any compensation received from an insurance company and the responsible individuals, should be:

- adjusted to the construction cost, if construction is still in progress; or
- charged as non-operating expenses in the current period, if construction is already complete.

Article 29

Construction in progress includes pre-construction preparation work, construction work-in-progress, installation projects, technical improvement projects and major overhaul projects. If an enterprise has a lot of fixed asset construction projects and project expenses are material, it should account for those projects separately according to the different nature of each project.

Construction in progress should be recorded at actual costs incurred and be accounted for separately.

Article 30

A self-managed project for fixed asset construction should be measured at direct material, direct labour and direct overhead costs etc. An out-sourced project for fixed asset construction should be measured at the project price payable. The cost of an equipment installation project should be determined at an amount including the price of the equipment, project installation costs and other related expenses incurred during test runs of the equipment.

Article 31

Net expenditure incurred during test runs of a fixed asset before it has reached the working condition for its intended use should be included as construction costs. For saleable goods produced during the test run stage:

- the production costs arising should be included in cost of construction in progress;
- the actual or estimated sales proceeds should be deducted from cost of construction in progress, when the goods are sold or transferred to inventory.

Article 32

If an individual item or a unit of a fixed asset construction project has been scrapped or destroyed, the net loss after deducting the scrap value and any compensation received from the responsible individuals or an insurance company should be recognized as project costs of the continuing project. If an item has been scrapped or destroyed due to abnormal circumstances, or the whole project in progress has been scrapped or destroyed, the effect should be charged directly as a non-operating loss for the current period.

Article 33

If a constructed fixed asset has reached the working condition for its intended use but the final project accounts have not been completed and approved, the asset should be transferred to fixed assets at an estimated value based on project budget, contracted construction price or actual project costs. Depreciation should also be provided in accordance with relevant requirements under this System. After the project accounts have been approved, the estimated values should be adjusted accordingly.

Article 34

Depreciation should be provided for the following fixed assets:

(1) properties and buildings;

(2) fixed assets in use including machines and equipment, instrument and apparatus, transportation vehicles, tools and utensils;

(3) fixed assets temporarily not in use due to seasonal factors or major overhaul;

(4) fixed assets acquired under finance leases or fixed assets leased out under operating leases.

For a fixed asset that has reached the working condition for its intended use and for which depreciation should be provided:

- if the final project accounts have been completed and approved in the current year, an enterprise should adjust the estimated value to actual costs and adjust the amount of provision for depreciation. Such adjustments should be treated as adjustments to costs or expenses in the current month.
- If the final project accounts have not been completed and approved in the current year, the fixed asset should be recorded at the estimated value and depreciation should also be provided. After the final accounts have been completed and approved, an enterprise should adjust the estimated value to actual cost, adjust the amount of provision for depreciation and adjust the opening balance of retained profits.

Article 35

No depreciation should be provided for the following fixed assets:

(1) fixed assets (other than properties and buildings) not yet put into use or that are redundant.

(2) fixed assets obtained for use under an operating lease;

(3) fully depreciated fixed assets that are still in use;

(4) land that is separately revalued and recorded as a fixed asset in accordance with relevant regulations.

Article 36

An enterprise should reasonably determine the expected useful lives and estimated net residual values of fixed assets according to the nature and pattern of use of the fixed assets. An enterprise should also select reasonable depreciation methods for fixed assets according to technological developments, environmental and other factors. The useful lives, residual values and depreciation methods should be approved in a shareholders' meeting or board of directors' meeting, managers'/factory managers' meeting or a meeting of other similar bodies in accordance with the management authority set-up in the enterprise. A copy of the approved bases should be sent for filing to relevant parties in accordance with laws and administrative regulations and one copy should be kept in the office of the enterprise for inspection by relevant parties (including investors). After approval and filing, changes to such bases should not be made without reasons. If a change is necessary, the change should only be made in accordance with the above approval and filing procedures and should be stated in the notes to the accounting statements.

An enterprise can use different depreciation methods, including straight-line method, unit of production method, sum-of-years'-digits method and double-declining-balance method. Once the depreciation method is selected, it should not be changed without reasons. If a change is necessary, it should be stated in the notes to accounting statements.

If the recorded amount of a fixed asset is adjusted because of reasons such as renovation and improvement, depreciation should be provided based on the adjusted recorded amount, expected remaining useful life and net residual value of the asset according to the selected depreciation method.

For a fixed asset obtained through donation, an enterprise should provide depreciation based on the recorded amount, expected useful life and estimated net residual value according to the selected depreciation method.

A fixed asset held under finance lease should be depreciated on the same basis as owned assets. If it is reasonably certain that the ownership of the leased asset will be transferred at the end of the lease term, depreciation should be provided over the useful life of the leased asset. If it is not reasonably certain that the ownership of the leased asset at the end of the lease term will be transferred, depreciation should be provided over the shorter of the lease term and the estimated useful life of the leased asset.

Article 37

An enterprise should normally provide depreciation on a monthly basis. No depreciation should be provided for fixed assets newly acquired in the month of addition; instead, they are depreciated starting from the following month. Depreciation should continue to be provided for fixed assets disposed of in the month of disposal; depreciation should cease from the following month.

No depreciation should be provided for a fully depreciated fixed asset whether it is still usable or not. No depreciation should be provided for fixed assets that have been early retired. An asset is fully depreciated when provision for depreciation has been made to cover the total depreciable amount of the fixed asset. Total depreciable amount is the cost of the fixed asset after deducting estimated residual value and adding back estimated costs of disposal costs.

Article 38

An enterprise should carry out major overhauls to fixed assets regularly. Major overhaul costs can be accrued in advance or deferred. If an enterprise uses the accrual method to account for major overhaul costs, such costs should be accrued evenly over the period between two major overhauls are carried out and included as relevant costs or expenses. If an enterprise uses the deferral method to account for major overhaul costs, such costs should be amortized evenly over the period up to next major overhaul and charged to relevant costs or expenses. *[Translator's note: Deferred overhaul costs are presented as an asset under the heading Deferred Expenses on the balance sheet, see Article 50 of this Accounting System.]*

Other routine repair expenses of fixed assets should be recognized as costs or expenses directly for the current period.

Article 39

Any net profit or loss arising from sale, retirement or destruction of fixed assets should be recognized as a gain or loss on disposal of fixed asset and included in non-operating gains or losses for the current period.

Article 40

A physical count of fixed assets should be carried out periodically, but at least once annually. An enterprise should investigate the reasons for any excess, loss of or destroyed fixed assets and prepare a written investigation report. Any excess, loss of or destroyed fixed assets should be resolved and approved in shareholders' meeting or directors' meeting, or managers'/factory managers' meeting or other similar bodies (according to the management authority set-up in the enterprise) before closing the accounts at the period end. The costs of excess fixed assets should be recognized as non-operating income for the current period; loss of or destroyed fixed assets should be charged as non-operating expenses for the current period after deducting any compensation received from the responsible individuals or insurance companies and the scrap value.

If approval has not been obtained for excess, loss of and destroyed assets before the end of the period, an enterprise should still adjust the financial reports in accordance with the above accounting treatments and state in the notes to the accounting statements that such adjustments have not been approved. If the amount approved subsequently is different, the difference should be adjusted to the opening balances of relevant accounting statements items.

Article 41

An enterprise should account for any acquisition, sale, disposal, retirement and internal transfer of fixed assets and prepare fixed asset sub-ledger accounts (or fixed assets cards) to account for these transactions.

Article 42

Fixed assets should be recorded at the lower of the carrying amount and recoverable amount at the end of each period. Where the recoverable amount is lower than the carrying amount, the difference should be recognized as provision for impairment loss on fixed assets.

In the balance sheet, provision for impairment loss on fixed assets should be presented as a deduction from the net amount *[Translator note: costs less depreciation]* of fixed assets.

Section 4 Intangible Assets and Other Assets

Article 43

An intangible asset is a non-monetary long-term asset without physical substance held for use in the production of goods or supply of services, for rental to others, or for administrative purposes. Intangible assets can be classified as either identifiable intangible assets or non-identifiable intangible assets. Identifiable intangible assets include patents, non-proprietary technologies, brand names, copyrights and land use rights. Non-identifiable intangible assets refer to goodwill.

An enterprise's internally generated goodwill and other items that do not fulfill the recognition criteria for intangible assets should not be recognized as intangible assets.

Article 44

An intangible asset should be measured at the actual cost of acquisition. The actual cost at the time of acquisition should be determined as follows:

(1) For a purchased intangible asset, the actual cost should be the actual purchase price.

(2) For an intangible asset received as a capital contribution by an investor, the actual cost should be the value agreed by all investing parties. However, if an intangible asset is contributed by an investor in exchange for an initial issue of shares, the intangible asset should be recorded at the carrying amount originally recorded in the books of the investor.

(3) For an intangible asset obtained by accepting non-cash assets from a debtor to satisfy a debt, or by exchanging a debt receivable for an intangible asset, the actual cost should be the carrying amount of the debt receivable plus any relevant tax payments. When boot is involved, the actual cost of the intangible asset should be determined as follows:

1. When boot is received, the actual cost should be the carrying amount of the debt receivable less the boot plus any relevant tax payments;

2. When boot is paid, the actual cost should be the carrying amount of the debt receivable and the boot paid, plus any relevant tax payments.

(4) For an intangible asset received in a non-monetary transaction, the actual cost should be the carrying amount of the assets surrendered plus any relevant tax payments. When boot is involved, the actual cost should be determined as follows:

1. When boot is received, the actual cost should be the carrying amount of the assets surrendered, plus any profit that should be recognized and relevant tax payments, less the boot received.

2. When boot is paid, the actual cost should be the carrying amount of the asset surrendered plus any relevant tax payments and the boot.

(5) For an intangible asset obtained through donation, the actual cost should be determined as follows:

1. if the donor has provided supporting documents, the actual cost should be determined in accordance with the amount on those supporting documents plus any relevant tax payments;

2. if the donor has not provided any supporting documents, the actual cost should be determined as follows:

    (a) if an active market exists for the same or similar type of intangible asset, the actual cost should be estimated by reference to the market price of the same or similar type of intangible asset, plus any relevant taxes;

    (b) if no active market exists for the same or similar type of intangible asset, the actual cost should be the present value of expected future cash flows of the donated intangible asset.

Article 45

For a self-developed intangible asset that is obtained by legal application, the actual cost capitalized should be the amount of expenditure incurred for the legal application for obtaining the asset, such as registration fees and legal fees. Other costs, including materials used in research and development, wages and benefits for staff directly involved in the development process, and rental expenses and borrowing costs incurred in the development process, should be expensed in the current period.

Research and development costs recognized as expenses in previous periods should not be capitalized upon the intangible asset becoming successfully developed and obtaining the right to the asset through legal application.

Article 46

The cost of an intangible asset should be amortized as an expense evenly over its expected useful life starting in the month in which it is obtained. If the expected useful life exceeds the beneficial period prescribed in the relevant contract or the effective period stipulated by law, the amortization period of an intangible asset should be determined according to the following principles:

(1) if the relevant contract prescribes the beneficial period but the law does not stipulate the effective period, the amortization period should not exceed the beneficial period prescribed in the contract;

(2) if the relevant contract does not prescribe the beneficial period but the law stipulates the effective period, the amortization period should not exceed the effective period stipulated by law;

(3) if the relevant contract prescribes the beneficial period and the law also stipulates the effective period, the amortization period should not exceed the shorter of the beneficial period and the effective period.

If the relevant contract does not prescribe the beneficial period and the law does not stipulate the effective date, the amortization period should not exceed 10 years.

Article 47

Land use rights acquired by an enterprise by means of a purchase or a payment for land transfer (transfer from the State) should be accounted for as an intangible asset before construction work (for own-use purpose) or development commences, and should be amortized over the period prescribed by this Accounting System. When a property development enterprise uses the land to develop properties held for sale, the carrying amount of the relevant land use rights should be transferred to property development costs. When an enterprise uses the land to construct fixed assets for own use, the carrying amount of the land use rights should be transferred to the costs of construction in progress *[Translator note: that is, fixed assets under construction]*.

Article 48

On disposal of an intangible asset, the difference between the carrying amount of the intangible asset and the disposal proceeds should be recognized as gain or loss for the current period.

An enterprise should recognize rental income earned on leasing intangible assets in accordance with the revenue recognition criteria as stipulated in this System. Related rental expenses should be recognized at the same time.

Article 49

An intangible asset should be recorded at the lower of the carrying amount and the recoverable amount. Where the recoverable amount is lower than the carrying amount, the difference should be recognized as a provision for impairment loss on intangible assets.

Intangible assets should be presented in the balance sheet at an amount net of provision for impairment loss.

Article 50

Other assets are assets other than those described above, such as long-term deferred expenses.

Long-term deferred expenses are other expenses paid by an enterprise, for which the amortization period is more than one year (excluding one year), including fixed assets overhaul costs and costs of improvements to leased fixed assets. Expenses that should be borne by the current period such as interest on borrowings *[Translator's note: interest may be capitalized as fixed assets where appropriate]* and rental expenses should not be treated as long-term deferred expenses.

Long-term deferred expenses should be accounted for separately and amortized evenly over the respective beneficial periods. Overhaul costs should be amortized evenly over the period up to the next major overhaul, if the deferral method is used. Costs of improvements to a leased asset should be amortized over the shorter of the lease term and the useful life of the leased asset. Other long-term deferred expenses should be amortized evenly over the respective beneficial periods.

On issuance of shares by a joint stock limited company, the issue costs including fees and commissions paid to other entities (after deducting interest income earned on the subscription money held before shares are allotted), to the extent that the share premium, if any, is inadequate to offset such costs, should be recognized directly in the income statement for the current period if the amount is not significant. If the amount of such costs is significant, they may be treated as long-term deferred expenses and amortized as an expense evenly over a period not exceeding two years.

Unless related to the acquisition or construction of fixed assets, all expenditure incurred during the pre-operating period should be accounted for as long-term deferred expenses. Such deferred expenses should be recognized as expenses in the month in which the enterprise commences operation.

If a long-term deferred expense item is unable to generate benefits for future accounting periods, the unamortized amount of that item should be recognized in the income statement for the current period.

Section 5 Impairment of Assets

Article 51

An enterprise should perform a comprehensive review of all assets periodically, but at least at the end of each year, and should reasonably assess any potential losses on assets that may have occurred according to the prudence principle and make provisions for impairment losses on assets that may be impaired.

An enterprise should make provisions for impairment losses on assets on a reasonable basis. However, no hidden [excessive] provision should be made. If there is reliable evidence indicating an enterprise has made hidden provisions by applying the prudence principle improperly, it should be corrected as a significant accounting error. The nature of this incident, the amount of the adjustment, and the effect on the financial position and operating result of the enterprise should be disclosed in the notes to the accounting statements.

Article 52

An enterprise should perform a comprehensive review of all current investments at the end of each period. Current investments should be measured at the lower of cost and market value. Where the market value is lower than cost, the difference should be recognized as a provision for impairment loss on current investments.

In applying the "lower of cost and market value" method for measuring current investments, an enterprise may, according to the specific circumstances, recognize a provision for impairment losses on the basis of all investments in aggregate, or individual classes of investments, or individual investments. If the value of a current investment is significant (that is, it accounts for 10% or more of total current investments), the provision for impairment loss on this current investment should be determined and recognized separately.

An enterprise should review the outstanding principal amounts of indirect loans periodically and record such loans at the lower of the principal amount and recoverable amount. If the recoverable amount is lower than the principal amount of an indirect loan, the difference should be recognized as a provision for impairment loss. In the balance sheet, the principal and interest receivable of an indirect loan should be presented at an amount net of any provision for impairment loss and included under current investments or long-term debt investments.

"Recoverable amount" is defined in this System to be the higher of (a) an asset's net selling price and (b) the present value of estimated future cash flows expected to arise from the continuing use of the asset and from its disposal at the end of its useful life. Net selling price is an asset's selling price less any costs of disposal of the asset. For a long-term investment, recoverable amount is the higher of the investment's net selling price and the present value of the estimated future cash flows expected to arise from holding the investment and from its disposal at maturity. Net selling price is the sale proceeds less any relevant taxes and expenses.

Article 53

An enterprise should analyze the recoverability of all accounts receivable at the end of a period, and estimate any potential bad debt losses. Provision for bad debts should be made for estimated potential bad debt losses. An enterprise should determine its own methods for making provisions for bad debts. An enterprise should set policies in respect of provision for bad debts and clearly define the scope, methods for determining the provision, ageing classifications and applicable percentage provision. Details of these policies should be sent to relevant parties in accordance with laws and administrative regulations and kept in the office of the enterprise. After the policies are determined, no change should be made without reasons. If a change is necessary, the change should be stated in the notes to the accounting statements

An enterprise should reasonably determine the appropriate [percentage] for provision for bad debts based on relevant information such as past experience, actual financial position and cash flows of the debtors.

Unless there is reliable evidence showing that an account receivable is not recoverable or unlikely to be recovered (for example, where a debtor is de-registered, bankrupt, insolvent, seriously cash deficient, or suffering from a natural disaster, such that the debtor's operation has stopped and the debtor is unable to repay a debt in the near future, or an account receivable has been outstanding for more than three years), an enterprise should not make full provision for bad debts in the following circumstances:

(1) accounts receivable arising in the current year;

(2) accounts receivable that are planned to be restructured;

(3) accounts receivable with related parties;

(4) other overdue accounts receivable, where no reliable evidence exists that the amount will not be recovered.

If there is reliable evidence indicating that a prepayment no longer qualifies to be a prepayment, or the goods paid for will not be received because the supplier is bankrupt or de-registered, an enterprise should transfer the amount to other receivables and recognize a provision for bad debts under these requirements.

If there is reliable evidence indicating that an outstanding note receivable held by an enterprise is not recoverable or unlikely to be recovered, an enterprise should transfer the book balance to accounts receivable and recognize a provision for bad debts.

Article 54

An enterprise should perform a comprehensive review of inventories at the end of a period. If the cost of inventories is higher than the net realizable value, due to reasons such as the inventories are damaged, they have become wholly or partially obsolete, or their selling prices have declined below cost, the difference between cost and net realizable value should be recognized as a provision for decline in value. Net realizable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated expenses necessary to make the sale.

Provision for decline in value of inventories should be made by comparing cost with net realizable value on an individual item basis. Where certain items of inventory have similar purposes or end uses and relate to the same product line produced and marketed in the same geographical area, and therefore cannot be practicably evaluated separately from other items in that product line, costs and net realizable values of those items may be determined on an aggregate basis. For large quantity and low value items of inventories, costs and net realizable values may be determined based on classes of invent ories. The carrying amount of inventory should be recognized as an expense in full for the current period if one or more of the following conditions exist:

(1) spoiled inventory;

(2) obsolete inventory with no resale value;

(3) inventory that is no longer needed for production with no other use or resale value.

(4) other inventory proved to have no use or resale value.

Article 55

Provision for decline in value of inventories should be recognized if any of the following conditions exists:

(1) The market price has continuously declined and is not expected to recover in the foreseeable future.

(2) Raw materials that will be used in a final product whose production cost exceeds its selling price.

(3) Raw materials that are not suitable for the production of new products (that have replaced old products) and the market price of the raw materials is lower than their book cost [carrying amount].

(4) The market price of the goods and services provided by an enterprise declines gradually due to a change of market conditions because the goods or services are outdated or consumers' preferences have changed;

(5) Other conditions sufficient to prove that inventory is actually impaired.

Article 56

An enterprise should review each long-term investment, fixed asset and intangible asset at the end of a period. Where the recoverable amount of such an asset is lower than its carrying amount due to reasons such as continuing decline of market prices, deteriorating operation of an investee enterprise, technological obsolescence, or the assets are damaged or redundant for a long period, a provision for impairment loss on the investment, fixed asset or intangible asset should be made respectively.

Provisions for impairment losses on long-term investments, fixed assets and intangible assets should be recognized on an individual item basis.

Article 57

In determining whether a provision should be made for impairment loss on a long-term investment with quoted market prices, an enterprise may consider the following indications:

(1) The market price continues to be lower than the carrying amount for two consecutive years.

(2) Trading of the investment has ceased for one year or longer.

(3) The investee has incurred significant losses in the current year.

(4) The investee has incurred losses for two consecutive years.

(5) The investee is under reorganization or liquidation or there are other indications that it may not be a going concern.

Article 58

In determining whether a provision should be made for impairment loss on a long-term investment without quoted market prices, an enterprise may consider the following indications:

(1) It is likely that the investee will incur significant losses due to changes in political or legal environment, for example, the enactment or amendment of tax laws or trade regulations.

(2) A significant deterioration of the investee's financial position due to a change of market demands because the goods or services provided by the investee are outdated or consumers' preferences have changed

(3) A significant deterioration of the investee's financial position resulting in reorganization or liquidation, etc. because the investee has become non-competitive due to technological changes in the industry.

(4) Other evidence sufficient to prove that the investment is actually no longer able to generate future economic benefits to the enterprise.

Chapter 2: Assets

Article 59

Where the fixed assets of an enterprise have actually become impaired, a provision for impairment loss should be recognized. Full provision should be made for impairment of a fixed asset if any one of the following conditions exists:

(1) The fixed asset has become redundant for a long period of time, will not be used in the foreseeable future and has no resale value.

(2) The fixed asset is not usable due to technological advancement.

(3) The fixed asset produces large quantity of sub-standard products.

(4) The fixed asset has been damaged such that it has no use or resale value.

(5) Other fixed assets that are practically unable to generate future economic benefits to the enterprise.

Depreciation should not be provided for fixed assets that have been impaired in full.

Article 60

The carrying amount of an intangible asset should be expensed in full in the income statement for the current period if any one or more of the following conditions exist:

(1) The intangible asset is replaced by a new technology such that it has no use or resale value;

(2) The legal protection period for the intangible asset has lapsed and the asset is not able to generate any future economic benefits to the enterprise.

(3) Other conditions are sufficient to prove that the intangible asset has no use or resale value.

Article 61

Provision for impairment loss on intangible assets should be recognized if one or more of the following conditions exist:

(1) The intangible asset is replaced by other new technologies that adversely affect its ability to generate economic benefits.

(2) The market value of the intangible asset has declined significantly during the period and it is not expected to recover during the remaining amortization period.

(3) The legal protection period for the intangible asset has lapsed but it still has some value for use.

(4) Other conditions are sufficient to prove that the intangible asset has actually impaired.

Article 62

Where the amount of the provision for impairment loss on an asset estimated by an enterprise at the end of the current period exceeds the carrying amount of the provision for impairment account, the difference should be recognized as additional provision. Where the amount estimated at the end of the current period is lower than the carrying amount of the provision for impairment account, the impairment losses previously provided should be reversed, but the reversal is limited to the carrying amount of the provision for impairment account. Actual asset losses should be charged against the provision for impairment losses account.

If an asset impairment loss previously recognized and charged to income is recovered subsequently, the relevant provision for impairment loss should be adjusted.

If an enterprise improperly manipulates accounting estimates, it should be treated as a significant accounting error and any subsequent adjustment should be treated as a correction of significant accounting error. Accordingly, when an excessive provision for impairment loss arising from improperly manipulating accounting estimates is reversed in the current period, the adjustment should be made such that the original effects are exactly reversed (If the excessive provision for impairment was made retrospectively against prior year figures, the reversal of the excessive provision should adjust against prior year figures. If the provision for impairment was charged against profit for the preceding period, the reversal should be credited to profit for the preceding period). The reversal should not increase the profit for the current period.

Article 63

Upon disposal of an impaired asset, including disposal by way of a debt restructuring, a non-monetary transaction and exchanging an asset for accounts receivable, the balance on the related provision account for impairment loss on that asset should also be cleared.

Article 64

An enterprise should investigate the reasons for non-recoverable accounts receivable, long-term investments, etc. and hold responsible parties accountable. Where there is reliable evidence that those accounts receivable and long-term investments etc. are not recoverable (for example, the debtor is de-registered, bankrupt, insolvent, or seriously cash deficient), the non-recoverable amounts should be written off against the provision for impairment loss. These asset losses should be approved in a shareholders' meeting, board of directors' meeting, managers'/factory managers' meeting or a meeting of other similar bodies according to the management authority set-up in the enterprise.

Article 65

Where an enterprise's construction in progress *[Translator note: that is, fixed assets under construction]* is assessed to be impaired, for instance, where construction work has been suspended for a long period of time and is not expected to re-commence within three years, the enterprise should recognize a provision for impairment loss in accordance with the above principles.

Chapter 3: Liabilities

Artide 66

A liability is a present obligation arising from past transactions or events; the settlement of such an obligation is expected to result in an outflow from the enterprise of resources embodying economic benefits.

Article 67

An enterprise's liabilities should, according to their liquidity, be classified as current and long-term liabilities.

Section 1 Current Liabilities

Article 68

Current liabilities are liabilities that are to be settled within one year (including one year) or within an operating cycle that is longer than one year, including short-term borrowings, bills payable, accounts payable, receipts in advance, wages payable, employee benefits payable, dividends payable, tax payable, other temporary accounts payable, accrued expenses and the portion of the long-term borrowings due within one year.

Article 69

Current liabilities should be recorded based on the actual amount incurred. Interest expense should be accrued on a periodic basis for short-term borrowings, interest-bearing bills payable and short-term bonds payable, based on the principal amount or the face value of the bonds and the specific interest rate, and recognized in the income statement.

Article 70

An enterprise should account for a debt restructuring undertaken with its creditors as follows:

(1) where a debt is settled by cash at an amount less than the carrying amount of the debt, the difference should be recognized as capital reserve.

(2) where a debt is settled by a transfer of a non-cash asset, the debt payable should be cleared at its carrying amount. The difference between the carrying amount of the debt and the carrying amount of the non-cash asset transferred in satisfaction of the debt should be recognized as capital reserve or as a non-operating loss in the current period.

(3) where a debt is converted into capital, it should be accounted for as follows:

1. in the case of a joint stock limited company, the aggregate face value of the capital to which the creditor becomes entitled for waving a debt should be recognized as capital. The difference between the carrying amount of the debt and the amount of the capital into which the debt was converted should be recognized as capital reserve.

2. In the case of other enterprises, the equity interest to which the creditor becomes entitled for waiving a debt should be recognized as paid-up capital. The difference between the carrying amount of the debt and the amount of the paid-up capital should be recognized as capital reserve.

(4) Where a debt restructuring involves the modification of terms of a debt and the amounts payable in the future after the modification are less than the carrying amount of the debt before restructuring, the difference should be recognized as capital reserve. If the modified terms involve contingent payments, the contingent payments should be included in the amounts payable in the future. If the amounts payable (including contingent payments) in the future are less than the carrying amount of the debt before restructuring, the difference should be recognized as capital reserve. If the conditions for contingent payments stipulated in the debt restructuring agreement are not satisfied during the debt repayment period, i.e., the contingent payments do not occur, the amount originally recorded for contingent payments should be recognized as capital reserve.

If the [undiscounted] amounts payable in the future after the modification of terms of a debt are equal to or greater than the carrying amount of a debt before debt restructuring, no adjustment is required at the time of restructuring. Debts payable in which the terms have been modified should be accounted for as ordinary debts according to this Accounting System.

“Contingent payments” referred to in this Accounting System are payments that are dependent on the occurrence of specified future events, the occurrence of which is uncertain.

Section 2 Long-term Liabilities

Article 71

Long-term liabilities are liabilities that will be settled after one year or after an operating cycle that is longer than one year, including long-term borrowings, bonds payable and long-term payables.

Each long-term liability should be accounted for separately and disclosed as a separate item in the balance sheet. The portion of long-term liabilities that is due for settlement within one year should be classified as a current liability in the balance sheet and disclosed separately.

Article 72

Long-term liabilities should be recorded at the actual amount incurred

Interest should be accrued on a periodic basis based on specific interest rates and the principal amount of the liabilities or the face value of bonds, and recognized either as project cost *[Translator note: for fixed assets under construction]* or current period financial expenses respectively in accordance with the requirements of this Accounting System.

Where an enterprise adopts the tax effect accounting method, the effect on income tax resulting from taxable timing differences or deductible timing differences should be accounted for separately as an adjustment to the tax expense for the current period.

Chapter 3: Liabilities

Article 73

Where bonds are issued, an enterprise should record a liability at the aggregate amount of the proceeds of issue. The difference between the proceeds of issue and the face value of the bonds should be accounted for as premium or discount. The premium or discount should be amortized by the effective-interest-rate method or the straight -line method over the life of the bonds along with the interest, and be accounted for using the accounting principles as for borrowing costs.

Article 74

Where convertible bonds are issued, an enterprise should account for the convertible bonds issued in the same way as ordinary bonds before conversion is made. When the bondholders exercise their rights to convert the bonds into shares or capital, the carrying amount of the bonds should be cleared. The difference between the carrying value of the convertible bonds and the par value of the shares issued or capital issued should be treated as capital reserve after deduction of any cash payments.

Where convertible bonds with an option to redeem are issued, an interest premium over and above the nominal interest on the bonds may become payable on the date of redemption. The interest premium should be accrued as interest payable between the date of issue and date of redemption of the bonds, and accounted for using the accounting principles as for borrowing costs.

Article 75

For a fixed asset acquired under finance lease, the fixed asset should be recorded at an amount equal to the lower of the carrying amount of the leased asset originally recorded in the books of the lessor and the present value of the minimum lease payments at the inception of the lease. The enterprise should record the minimum lease payments as long-term accounts payable. The difference between the recorded amount of the leased asset and the liability should be recorded as unrecognized finance charges.

If leased assets (leased under finance leases) represent 30% or less of the total assets of an enterprise, both the leased asset and the long term liability should be recorded at an amount equal to the minimum lease payments at the inception of the lease.

Article 76

Where an enterprise receives a grant of funding for a specific project *[Translator note: typically a grant allocated from the government]*, it should be accounted for as a specific account payable. On completion of the specific project, the specific account payable should be reduced by the appropriate amount, and the balance should be transferred to capital reserve.

Article 77

Borrowing costs incurred by an enterprise are interest incurred on borrowings, amortization of discounts or premiums, ancillary costs incurred in connection with the arrangement of borrowings, and exchange differences arising from foreign currency borrowings. Ancillary costs include handling charges.

Except for those borrowing costs incurred on a specific borrowing for the acquisition or construction of a fixed asset, borrowing costs should be recognized as expenses and included as finance charges in the period in which they are incurred.

Under this Accounting System, a specific borrowing is one borrowed specifically for the acquisition or construction of a fixed asset.

Borrowing costs on specific borrowings incurred for the acquisition or construction of fixed assets should be accounted for as prescribed below:

(1) Treatment for ancillary costs incurred in connection with borrowings:

1. when an enterprise issues bonds to raise funds for the acquisition or construction of a fixed asset, before the fixed asset has reached working condition for its intended use, the issue costs incurred in connection with the offering of bonds (after deduction of interest income earned from the subscription money received before the issuance of the bonds) should be capitalized as the cost of the fixed asset if the amount is significant. If the amount is not significant, the amount (after deduction of interest income earned from the subscription money received before the issuance of the bonds) should be included as finance charges in the period in which they are incurred.

   Handling fees incurred in connection with bank borrowings should also be treated according to the above principle.

2. Ancillary costs (other than bond issue costs and handling fees on bank borrowings) on specific borrowings, to the extent incurred before the fixed asset has reached working condition for its intended use, should be capitalized as the cost of the fixed asset if the amount is significant. Ancillary costs incurred after the fixed asset has become ready for its intended use should be recognized as finance charges in the period in which they are incurred. If the amount of the ancillary costs is not significant, they may be recognized as finance charges in the period in which they are incurred.

(2) Treatment for interest incurred on borrowings, amortization of discounts or premiums and exchange differences:

1. An enterprise should commence capitalization of interest, amortization of discounts or premiums, and exchange differences arising from specific borrowings for the acquisition or construction of a fixed asset and include the capitalized amount as cost of the fixed asset when all the following three conditions are satisfied:

   (i) expenditures for the asset (limited to only those expenditures that have resulted in payments of cash, transfer of non-cash assets or the assumption of interest-bearing liabilities) are being incurred;

(ii) borrowing costs are being incurred; and

(iii) activities necessary to prepare the asset for its intended use have commenced.

2. Interest incurred, amortization of discounts or premiums, and any exchange differences related to specific borrowings for the acquisition or construction of a fixed asset should be capitalized as cost of the fixed asset if the above conditions are satisfied, to the extent they are incurred before the fixed asset has reached working condition for its intended use. To the extent such costs are incurred after the fixed asset has reached working condition for its intended use, they should be recognized as finance charges in the period in which they are incurred. The amount of interest to be capitalized for each accounting period should be computed in accordance with the following formula:

   The amount of interest to be capitalized for each accounting period = The weighted average amount of accumulated expenditures for the acquisition or construction of fixed assets incurred up to the end of the current period x The capitalization rate

   Weighted average amount of the accumulated expenditure = $\sum$ (Amount of individual expenditures on asset x Number of days the expenditures were actually outstanding during the accounting period divided by Number of days in the accounting period)

   For simplicity, the number of months may be used as the factor to calculate the weighted average amount of the accumulated expenditure.

   The capitalization rate should be determined as follows: if only one specific borrowing was used for the acquisition or construction of a fixed asset, the capitalization rate should be the rate on that borrowing. If more than one specific borrowing was used for the acquisition or construction of a fixed asset, the capitalization rate should be the weighted average interest rate on those specific borrowings. The weighted average interest rate should be calculated as follows:

   Weighted average interest rate = "Summation of the actual amounts of interest on specific borrowings incurred during the period" divided by "The weighted average amount of outstanding principals of specific borrowings" x 100%

   Weighted average amount of outstanding principals of specific borrowings = $\sum$ (Principal of each specific borrowing X "Number of days each specific borrowing was actually outstanding during the accounting period" divided by "Number of days in the accounting period")

   For simplicity, the number of months may be used as the factor to calculate the weighted average amount of outstanding principals of specific borrowings.

   If there is a discount or premium on the bonds issued by an enterprise, interest cost should be adjusted by the amount of amortization of such discount or premium and the capitalization rate

should be adjusted accordingly. The weighted average interest rate should be determined in accordance with the following formula:

Weighted average interest rate = (Summation of the actual amounts of interest on specific borrowings incurred during the period ± Amortization of discount or premium) divided by "Weighted average amount of the outstanding principals of specific borrowings" x 100%

3. The exchange differences (related to both principal and interest) arising in each accounting period in connection with specific borrowings denominated in foreign currency should be capitalized as cost of the fixed asset to the extent incurred before the fixed asset has reached working condition for its intended use. After the fixed asset has reached working condition for its intended use, the exchange differences should be recognized as finance charges in the period in which they are incurred.

4. If the bond issue costs incurred by an enterprise are less than the interest income earned from the subscription money received before the issuance of the bonds, the difference should be treated as premium arising from bond issue, and amortized over the life of the bond along with the interest expense.

5. The amount of interest and amortization of discount or premium capitalized for each period should not exceed the actual amount of interest incurred and discount or premium amortized in respect of specific borrowings during the period.

   In determining the amount of borrowing costs to be capitalized, interest income earned in connection with specific borrowings *[Translator note: interest income may arise from temporary investment of those borrowings]* should not be used to reduce the acquisition or construction cost of the fixed asset. The interest income should be netted off the finance charges for the current period.

6. Where an enterprise raises funds (specifically to acquire or construct a fixed asset) other than by borrowing, for instance through grants or the issue of shares, the borrowing costs on specific borrowings raised before such funds are received should be treated under the above principles. After such funds are received, the borrowing costs should be treated as follows:
   - charged as finance charges, when the actual expenditure for the asset has not exceeded the amount of funds raised other than by borrowing;
   - treated as borrowing costs under the above principles, when the actual expenditure for the asset has exceeded the amount of funds raised other than by borrowing. However, the amount of funds raised should be deducted from the weighted average cumulative expenditure for the period.

7. When the construction of a fixed asset is completed in parts and each part is capable of being used while construction continues on other parts, capitalization of borrowing costs (attributable to the completed parts) should cease when substantially all the activities necessary to prepare that part

for its intended use are completed. Thereafter, borrowing costs should be included as finance charges for the current period. When the construction of a fixed asset is completed in parts but each part cannot be used until all parts are completed, capitalization of borrowing costs should cease when all parts are completed. Thereafter, the borrowing costs should be included as finance charges for the current period.

8. Capitalization of borrowing costs should be suspended during periods in which the acquisition or construction of a fixed asset is interrupted abnormally, and the interruption period is three months or longer. These costs should not be capitalized and should be recognized as finance charges for the current period until the acquisition or construction activities are resumed. After the activities are resumed, borrowing costs are capitalized until the fixed asset reaches working condition for its intended use.

   However, capitalization of borrowing costs during the suspended periods should continue when the interruption is a necessary part of the process of bringing the asset to working condition for its intended use.

   Capitalization of borrowing costs should cease when the fixed asset being acquired or constructed has reached working condition for its intended use. Borrowing costs incurred thereafter should be recognized as a finance charge in the period in which they are incurred.

Article 78

Under this Accounting System, a fixed asset has “reached working condition for its intended use” if the asset has reached working condition for the use intended by the purchaser or constructer. A fixed asset has reached working condition for its intended use when any of the following conditions are satisfied:

(1) the physical construction (including installation) of the fixed asset is completed or substantially completed;

(2) the results of the trial production or test run prove that the fixed asset can produce qualifying products in a stable way or the trial operation process proves that the fixed asset can operate normally.

(3) expenditure to be incurred further for construction of the fixed asset is minimal or virtually zero;

(4) the fixed asset being acquired or constructed meets the specification or requirements in the contract, or substantially meets such specification or requirements, and any non-compliance will not affect the normal use of the fixed asset.

Chapter 4: Owners' Equity

Article 79

Owners' equity is the economic interest in the assets of an enterprise attributable to the owners. The amount is the balance of assets after deducting all liabilities. Owners' equity includes paid-in capital (or share capital), capital reserve, surplus reserve, and unappropriated profits.

Article 80

Paid-in capital is the actual amount of capital contributed by the investors in an enterprise in accordance with the memorandum and articles of incorporation/establishment of the enterprise, investment contracts or agreements.

(1) Paid-in capital of general enterprises [that is, enterprises other than joint stock limited enterprises] should be accounted for as follows:

1. For capital contributed in cash by an investor, paid-in capital should be recorded at the amount actually received or deposited in the enterprise's bank account. The excess of the amount received or deposited over an investor's proportion of registered share capital should be recognized as capital reserve.

2. For capital contributed in non-cash assets by an investor, paid-in capital should be recorded at an amount agreed by all investing parties. An intangible asset contributed by an investor for the enterprise's initial issue of shares should be recorded at its carrying amount in the books of the investor.

3. Foreign currencies contributed by an investor should be translated at the rate prevailing on the date of receipt of the foreign currencies, if exchange rates are not specified in the investment contract. If exchange rates are specified in the investment contract, foreign currencies contributed should be translated at the specified rates. The translation difference resulting from different exchange rates should be accounted for as capital reserve.

4. If a Sino-foreign co-operative enterprise returns certain amounts invested back to the investors in accordance with relevant laws and regulations during the co-operative period, the invested amounts returned back to the investors should be accounted for separately and presented separately as a deduction from paid-in capital in the balance sheet.

(2) Share capital of a joint stock limited company should be accounted for as follows:

1. A company should obtain its share capital by issuing shares within the limit of its authorized amount of share capital and authorized number of shares. When a company issues shares, share capital should be recognized at par value. Any excess of the share issue proceeds over the par value of the share capital issued represents share premium and should be recognized as capital reserve.

2. For companies listed outside mainland China and domestic companies that issue foreign shares within mainland China, the paid-in capital should be recorded at an amount equal to the par value per share denominated in RMB multiplied by the number of shares issued. The difference between the amount of share issue proceeds translated to RMB at the exchange rate prevailing on the date the proceeds were received and the aggregate par value of share capital should be recognized as capital reserve.

Article 81

Capital (or share capital) of an enterprise should not be changed arbitrarily. Changes may be made under the following circumstances:

(1) If an enterprise meets the conditions to increase capital and the increase is approved by relevant authorities, it should record the increase when it receives the contributions from the investors.

(2) If an enterprise applies for reduction of registered capital in accordance with statutory procedures, the reduction should be recorded when capital invested is actually returned. If an enterprise reduces its capital by way of share repurchases, the reduction should be recorded when the shares are actually repurchased.

(3) The information in relation to cancellation of shares, repayment of share capital, and changes in details of shares as a result of capital reduction should be recorded in the relevant sub-ledgers under share capital account and relevant memorandum records.

Where an investor transfers his contributed capital to another party according to relevant regulations, an enterprise should update the relevant sub-ledgers under the capital (or share capital) account and relevant memorandum records by recording the amount of capital being transferred from the transferor to the transferee once the transfer is completed.

Article 82

Capital reserves include capital premium (or share premium) and reserves arising from asset donations, government grants and translation differences of foreign currency. Capital reserves mainly comprise the following sub-ledger accounts:

(1) "capital premium (or share premium)", being the amount of funds contributed by an investor in excess of the investor's share of the registered capital;

(2) "restricted capital reserve arising from non-cash asset donations received" *[Translator note: Restricted capital reserve cannot be used to increase capital]*, being an increase in capital reserve resulting from the acceptance of non-cash asset donations. When the asset is ultimately disposed of, the amount will be transferred from this sub-ledger account to the "other capital reserves" sub-ledger account.;

(3) "cash donations received", being an increase in capital reserve resulting from the acceptance of cash donations;

(4) "restricted reserve arising from equity investment", being an increase in capital reserve in the accounts of an investing enterprise resulting from its proportional share of an investee enterprise's own increase in capital reserve (due to acceptance of donations, etc) under equity accounting;

(5) "government grants received"; When an enterprise receives grants from the State for technology improvement and research projects, the enterprise should, upon completion of such projects, transfer the appropriate amount to capital reserve in accordance with relevant regulations, and record the transferred amount accordingly.

(6) "exchange difference related to foreign currency capital contribution", being differences arising from translating foreign capital contribution received at different exchange rates;

(7) "other capital reserves", being items other than the above, and transfers from "capital reserve provision accounts". Any debt waived by the enterprise's creditors is accounted for under this item.

"Restricted capital reserves cannot be used to increase capital (or share capital).

Article 83

Surplus reserves should include the following items in accordance with the nature of an enterprise.

(1) For general enterprises and joint stock limited companies, surplus reserves include the following:

1. statutory surplus reserve, being a surplus reserve appropriated from net profit in accordance with a percentage prescribed in regulations;

2. discretionary surplus reserve, being a surplus reserve appropriated from net profit in accordance with a prescribed percentage approved in a general meeting of the shareholders or a similar body;

3. statutory public welfare fund, being a fund set aside from net profit for the purpose of staff welfare. When the statutory public welfare fund is utilized to provide staff welfare, the amount utilized should be transferred to discretionary surplus reserve;

   Surplus reserves of an enterprise can be used to offset accumulated losses or increase capital (or share capital). Where an enterprise satisfies the stipulated conditions, surplus reserves can also be used to distribute cash dividends.

(2) For foreign investment enterprises, surplus reserves include the following:

1. reserve fund, [see above] being a fund appropriated from net profit in accordance with laws and administrative regulations which, when approved, can be used to offset accumulated losses or increase capital;

2. enterprise expansion fund,[SEE ABOVE] being a fund set aside from net profit in accordance with laws and administrative regulations for the purpose of production and development of the enterprise which, when approved, can be used to increase capital;

3. return of capital invested from profits, being return of capital invested back to the investors from profits by a Sino-foreign co-operative enterprise during the co-operative period in accordance with rules and regulations.

Chapter 5: Revenue

Article 84

Revenue is the gross inflow of economic benefits arising in the course of the ordinary activities of an enterprise, from such events as the sale of goods, the rendering of services and the use by others of enterprise assets. Amounts collected on behalf of third parties or clients are excluded from revenue.
An enterprise should recognize and measure revenue reasonably based on the nature of the revenue and in accordance with revenue recognition criteria.

Section 1 Revenue from Sales of goods and Rendering of Services

Article 85

Revenue from the sale of goods should be recognized when all of the following conditions have been satisfied:

(1) the enterprise has transferred to the buyer the significant risks and rewards of ownership of the goods;

(2) the enterprise retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold;

(3) the economic benefits associated with the transaction will flow to the enterprise; and

(4) the relevant amount of revenue and costs can be measured reliably.

Article 86

Revenue arising from the sale of goods should be determined in accordance with the amount stipulated in the contract or agreement signed by the enterprise and the buyer or an amount agreed between them. Cash discounts should be recognized as an expense in the period in which they are actually taken [in settling the debt]. Sales allowances should be recorded as a reduction of revenue in the period in which the allowances actually arise.

Cash discount is the amount of reduction of debt provided by a creditor to a debtor in order to encourage the debtor to pay within a prescribed period. Sales allowance is the amount of reduction in selling price because of defects in the goods sold, such as poor quality.

Article 87

Sales returns of goods sold for which revenue has already been recognized should be recorded as a reduction of revenue in the period in which the goods are returned. However, if goods sold at or before the balance sheet date are returned between the balance sheet date and the date on which the financial statements are approved for issue, the return should be treated as an adjusting event, and revenue, expense, assets, liabilities and owners' equity should be adjusted.

Chapter 5: Revenue

Article 88

When the provision of services is started and completed within the same accounting year, revenue should be recognized at the time of completion of the services. When the provision of services is started and completed in different accounting years and the outcome of a transaction involving the rendering of services can be estimated reliably, an enterprise should recognize the service revenue at the balance sheet date by the use of the percentage of completion method. The percentage of completion method is a method to recognize revenue and expenses by reference to the stage of completion of the services.

The outcome of a transaction can be estimated reliably when all of the following conditions are satisfied:

(1) the total amount of service revenue and costs can be measured reliably;

(2) the economic benefits associated with the transaction will flow to the enterprise; and

(3) the stage of completion of the services provided can be measured reliably.

The stage of completion of the services should be determined by the following methods:

(1) surveys of work performed;

(2) the proportion of services performed to the total services to be performed; or

(3) the proportion of costs incurred to the estimated total costs.

Article 89

When the outcome of a transaction involving the rendering of services cannot be estimated reliably, revenue should be recognized and measured at the balance sheet date as follows:

(1) if the service costs incurred are expected to be fully recoverable, an enterprise should recognize an amount equal to the costs incurred as revenue and charge an equivalent amount of cost to the income statement;

(2) if the service costs incurred are not expected to be fully recoverable, an enterprise should recognize revenue only to the extent of the costs incurred that are recoverable and recognize the [full amount of] costs incurred as an expense in the current period. The difference between the amount recognized as revenue and the amount of costs incurred should be recognized as a loss in the current period;

(3) if none of the service costs incurred are expected to be recovered, revenue is not recognized and the costs incurred are recognized as an expense in the current period.

Chapter 5: Revenue

Article 90

Total revenue arising from the rendering of services should be determined in accordance with the amount stipulated in the contract or agreement signed by the enterprise and the party who receives the services. Cash discounts should be recognized as an expense in the period in which they are actually taken [in settling the debt].

Article 91

Revenue arising from the use by others of enterprise assets includes interest and royalty.

(1) Interest and royalty should be recognized when all the following conditions have been satisfied:

1. the economic benefit associated with the transaction will flow to the enterprise; and
2. the amount of the revenue can be measured reliably.

(2) Interest and royalty revenue should be accounted for as follows:

1. interest should be measured based on the length of time for which the enterprise's cash is used by others and the applicable interest rate; and
2. royalty should be measured according to the period and method of charging as stipulated in the relevant agreement or contract.

Section 2 Construction Contracts Revenue

Article 92

A construction contract is a contract specifically negotiated for the construction of an asset or combination of assets that are closely interrelated in terms of their design, technology and function or their ultimate purpose or use.

(1) A fixed price contract is a construction contract in which the construction price is determined based on a fixed contract price, or a fixed price per unit of output.

(2) A cost plus contract is a construction contract in which the construction price is calculated based on contractually allowable or defined costs, plus a percentage of these costs or a fixed fee.

Article 93

Construction contract revenue comprises the initial amount of revenue agreed in the contract and revenues resulting from variations in contract, claims and incentive payments.

A variation in a contract is an instruction by the customer for a change in the scope of the work to be performed under the contract. Revenue arising from variation of the terms in contract should be recognized when the customer will approve the amount of revenue arising from the variation and the amount of revenue can be measured reliably.

A claim is an amount the contractor seeks to collect from the customer or another party as reimbursement for costs that were caused by the customer or another party and not included in the contract price. Revenue arising from claims should be recognized only when it is expected that the other party will accept the claims (according to the stage of the negotiation) and the amount that will be accepted by the other party can be measured reliably.

Incentive payments are additional amounts paid to the contractor as agreed by the customer if specified performance standards are met or exceeded. Revenue arising from incentive payments should be recognized when the contract is sufficiently advanced that the specified performance standards will be met or exceeded and the amount of incentive payment can be measured reliably.

Article 94

Construction costs of a contract should include the direct and indirect costs incurred and attributable to a contract for the period from the date the contact is signed to the final completion of the contract.

Direct costs include labor costs, costs of materials, expenses of equipment usage and related costs of design and technical assistance; costs of moving materials within the contract site, costs of using production tools and apparatus, costs of inspection and testing, costs of site feasibility testing, and costs of handover and site clean up.

Indirect costs are costs incurred by the construction unit or production unit of an enterprise for organizing and managing the construction operation. Such costs include amortization expenses of temporary equipment, salaries incurred by the management staff of the construction unit or production unit, bonuses, employee benefits and labor protection expenses, depreciation and maintenance of fixed assets, materials consumed, amortization of low-value consumable goods, heating fee, water and electricity charges, office expenses, traveling expenses, property insurance expenses, working maintenance expenses and sewage fee.

General administrative costs incurred by the administration department for organizing and managing operating activities, selling costs of manufacturing enterprises (such as ship manufacturers), finance costs incurred in obtaining finance for the operating needs of the enterprise and costs incurred for securing contracts should be recognized as expenses in the current period.

Direct costs should be included as contract costs when they are incurred. Indirect costs should be allocated using methods that are systematic and rational. Contract costs should be reduced by any incidental income that relates to the contract, for example, income from the disposal of surplus materials at the end of the contract.

Article 95

A contractor should recognize and measure revenue and expenses of a construction contract in accordance with the following principles:

(1) when the outcome of a construction contract can be estimated reliably, contract revenue and contract costs should be recognized as revenue and expenses respectively by reference to the percentage of completion method at the balance sheet date. Percentage of completion method is a method by which revenue and costs are recognized in accordance with the stage of completion of the contract.

1. In the case of a fixed price contract, the outcome of a contract can be estimated reliably when all of the following four conditions are satisfied:

   (1) total contract revenue can be measured reliably;
   (2) the economic benefits associated with the contract will flow to the enterprise;
   (3) both the stage of contract completion at the balance sheet date and the contract costs to complete the contract can be measured reliably; and
   (4) the contract costs attributable to the contract can be clearly identified and measured reliably so that actual contract cost incurred can be compared with prior estimates.

2. In the case of a cost plus contract, the outcome of a contract can be estimated reliably when both of the following conditions are satisfied:

   (1) the economic benefits associated with the contract will flow to the enterprise; and

   (2) the actual contract costs incurred can be clearly identified and measured.

(2) For a construction contract completed in the current period, the actual amount of the aggregate revenue earned, less the accumulated revenue recognized in previous accounting years, should be recognized as income in the current period. Meanwhile, the actual amount of accumulated contract costs incurred, less the accumulated contract costs recognized in previous accounting years, should be recognized as expenses in the current period.

(3) When the outcome of a construction contract cannot be estimated reliably, it should be accounted for as follows:

1. if the contract costs are recoverable, contract revenue should be recognized to the extent of the contract costs incurred that are recoverable; and contract costs should be recognized as expenses in the period in which they are incurred; and

2. to the extent that the contract costs will not be recovered, they should be recognized as expenses immediately when they are incurred; and contract revenue should not be recognized.

(4) Contract revenue and contract costs of a construction contract that is to be completed within an accounting year should be recognized at the time of completion.

(5) If expected aggregate contract costs exceed the expected aggregate contract revenue, the expected loss should be recognized as an expense in the current period.

Article 96

The stage of completion of a contract may be determined by the proportion that contract costs incurred for work performed to date bear to the estimated total contract costs, or the proportion that completed contract work bears to the estimated total contract work, or surveys of the work performed.

When the stage of completion is determined by reference to the contract costs incurred to date, only those contract costs that reflect work performed are included in costs incurred to date. Contract costs do not include: (1) contract costs that relate to future activities of the contract, and (2) payments made to subcontractors in advance of completion of subcontracting work.

Article 97

Revenue from the sale of property held for sale by a property developer should be recognized in accordance with the revenue recognition principles of sale of goods. If the transaction satisfies the conditions of a construction contract and the construction contract is non-cancelable, property development revenue may be recognized in accordance with the revenue recognition principles of a construction contract by reference to the percentage of completion method.

Article 98

Revenue of an enterprise should be reflected in the income statement in accordance with the principle of materiality.

Chapter 6: Costs and Expenses

Article 99

Expense is the outflow of economic benefits from the enterprise arising from ordinary activities such as sales of goods and provision of services. Cost comprises all expenditures incurred by an enterprise in the production of goods or provision of services.

An enterprise should reasonably distinguish between expenses for the period and costs. Expenses for the period should be directly charged to the income statement for the current period. Costs should be included as the costs for production of goods or provision of services.

An enterprise should recognize the cost of goods sold or cost of services provided in the current period as expenses for the period. A commodity trading enterprise should recognize the cost of purchase of goods as expenses for the period once the goods are sold.

Article 100

For materials used in the production and operating process, the amount used should be calculated based on the actual quantities consumed and the recorded unit price, and recorded as costs or expenses.

Article 101

For wages payable, the amount should be calculated based on information such as wage rates, hours worked, and production quantities. The amount should be recorded as costs or expenses. Wages should include prescribed staff benefits and allowances in the nature of wages.

An enterprise should, in accordance with State regulations, calculate and recognize staff welfare expenditure as costs or expenses.

Article 102

An enterprise should recognize other expenditures incurred in the production or operating process as costs or expenses according to the actual amounts incurred. Expenditures incurred but not yet paid in the current period should be accrued and included as costs or expenses for the current period. Expenditures paid but related to the current period as well as subsequent periods should be treated as deferred expenses and amortized as costs or expenses over the relevant periods.

Article 103

An enterprise should determine the cost centers, cost items and cost calculation methods according to the characteristics of the production and operating process and the needs of the management. Once determined, they should not be changed arbitrarily. Changes should be approved in a shareholders' meeting or directors' meeting, or managers'/factory managers' meeting or a meeting of a similar body according to the management authority set-up in the enterprise, and should be disclosed in the notes to the accounting statements.

Chapter 6: Costs and Expenses

Article 104

Expenses for the period include operating expenses, administration expenses and finance expenses. Such expenses for the period should be charged to the income statement for the current period and separately presented therein.

(1) Operating expenses are expenses incurred during the sales process, including freight charges, handling fees, packaging, insurance, exhibition and advertising expenses, and operating expenses of sales structures (sales network, after-sales services network etc.) including payroll and benefits, other expenses in the nature of wages, and business expenses.

For a commodity trading enterprises, operating expenses also include expenses arising from the process of purchasing merchandises.

(2) Administration expenses are expenses incurred in organizing and managing the operating activities of an enterprise. Administration expenses include expenses incurred by the enterprise's board of directors or administration department in management activities, central corporate expenses (including administration department's payroll costs, repair and maintenance, materials consumed, amortization of consumables, office expenses and business traveling expenses), union dues, unemployment insurance, labor insurance, directors' fees, professional fees, consulting fees (including fees for advisors), litigation expenses, entertainment expenses, rates on property, transportation tax, land use tax, stamp duties, technology transfer fees, expenses for use of mineral resources, amortization of intangible assets, training fees, research and development costs, sewage charges, deficit or excess inventories found during a stock-take (except losses on inventories that should be included as non-operating expenses), provision for bad debts and provision for decline in value of inventories.

(3) Finance expenses are expenses incurred by an enterprise in raising funds required for operations. Finance expenses include interest expenses that should be included as period cost (less interest income), exchange losses (less exchange gains), and other relevant handling charges.

Article 105

An enterprise must clearly identify the costs and expenses for the current period and those for subsequent periods. It must not accrue or defer expenses arbitrarily. An industrial enterprise must clearly identify the costs of each product. It must clearly identity the costs of work-in-progress and the costs of finished goods, and must not overstate or understate such costs.

Chapter 7: Profit and Profit Appropriation

Article 106

Profit is the operating result of an enterprise for a specific accounting period, including operating profit, total profit and net profit.

(1) Operating profit is an amount equal to (a) income from the principal business operations less related costs and business taxes; plus (b) profit from other business operations; less (c) operating expenses, administration expenses and financial expenses.

(2) Total profit is an amount equal to operating profits plus investment gains, subsidy income, non-operating income, less non-operating expenses.

(3) Investment gains represent a net amount equal to gains from external investments less the investment losses incurred and any provision for impairment losses on investments.

(4) Subsidy income comprises refund of value added tax actually received by an enterprise under regulations, or any lump-sum subsidy determined based on volume of sales or work performed in accordance with amounts specified under State regulations and paid to the enterprise periodically, and any other form of subsidy under the State's economic subvention plan.

(5) Non-operating income and non-operating expenses are any income or expenses that do not directly relate to the production or operating activities of the enterprise. Non-operating income includes excess items found in a fixed asset count, net gain on disposal of fixed assets, net gain on disposal of intangible assets, net income from penalties [for instance a penalty received for a breach of contract by a third party transacting with the reporting enterprise], etc. Non-operating expenses includes loss of fixed assets found in a fixed asset count, net loss on disposal of fixed assets, net loss on disposal of intangible assets, loss on debt restructuring, provisions for impairment losses on intangible assets, fixed assets and construction in progress [that is, fixed assets under construction], penalty payments, donation payments, and abnormal losses, etc.

Non-operating income and non-operating expenses should be accounted for separately and be presented in the income statement as separate items. Sub-ledgers should also be set up for specific non-operating income and non-operating expenses to account for them in detail.

(6) Income tax is the income tax expense that should be recognized in the income statement for the current period.

(7) Net profit is the amount of total profit less income tax.

Article 107

Income tax expense should be accounted for in accordance with the following principles:

(1) An enterprise should adopt either the tax payable method or the tax effect accounting method to account for income taxes according to its specific situation.

1. Under the tax payable method, an enterprise recognizes the income tax payable computed for the current period as income tax expense for the current period, and does not recognize the effect of timing differences. Under this method, the amount of income tax expense is the same as the amount of income tax payable for the current period.

2. Under the tax effect accounting method, an enterprise recognizes the effect of timing differences on income tax. It recognize the aggregate of income tax payable for the current period and the amount of income tax affected by timing differences as income tax expense for the current period. Under this method, the effect on income tax arising from timing differences should be deferred and allocated to subsequent periods. Enterprises that use tax effect accounting method can adopt either the deferral method or the liability method. Under the deferral method, when there are changes in tax rates or imposition of new taxes, no adjustment should be made to the income tax amounts originally recognized in respect of timing differences. Any reversal of the effect on income tax in respect of timing differences should be made at the original tax rate. Under the liability method, when there are changes in tax rates or imposition of new taxes, adjustments should be made to the income tax amounts originally recognized in respect of timing differences. Any reversal of the effect on income tax in respect of timing differences should be made at the current tax rate.

(2) Under the tax effect accounting method, an enterprise should reasonably distinguish between timing differences and permanent differences:

1. Timing differences are the differences between accounting profit before tax and taxable income due to different recognition periods for revenue, expenses and losses under tax rules and accounting requirements. Timing differences originate in one period and reverse in one or more subsequent periods. Timing differences mainly arise from the following:

   (i) A taxable timing difference arises when certain revenue is recognized in the current period under accounting requirements, but the revenue should be recognized as taxable income in subsequent periods under tax rules. A taxable timing difference is a timing difference that will increase taxable income in future periods.

   (ii) A deductible timing difference arises when certain expenses or losses are recognized in the current period under accounting requirements, but such expenses or losses are only deductible from taxable income in subsequent periods under tax rules. A deductible timing difference is a timing difference that will be deductible from taxable income in future periods.

   (iii) A deductible timing difference arises when certain revenue is recognized in subsequent periods under accounting requirements, but should be included in taxable income for the current period under tax rules.

(iv) A taxable timing difference arises when certain expenses or losses are recognized in subsequent periods under accounting requirements, but should be deducted from taxable income for the current period under tax rules.

2. Permanent differences are the differences between the accounting profit before tax (for a certain accounting period) and the taxable income due to different bases for measuring/recognizing revenue, expenses and losses under accounting requirements and tax rules. Permanent differences originate in the current period and do not reverse in subsequent periods. Permanent differences comprise the following:

(i) An item that is recognized as revenue in the accounting statements under accounting requirements, but is never recognized as revenue in determining taxable income;

(ii) An item that is never recognized as revenue in the accounting statements under accounting requirements, but is recognized as revenue in determining taxable income (that is, tax is payable thereon);

(iii) An item that is recognized as an expense or a loss in the accounting statements under accounting requirements, but is never deductible in determining taxable income;

(iv) An item that is never recognized as an expense or a loss in the accounting statements under accounting requirements, but is deductible in determining taxable income.

(3) Under the deferral method, tax expense for a certain period comprises:

1. Income tax payable for the current period;

2. A deferred tax credit or debit *[Translator note: referring to a credit or debit to the deferred taxation account in the balance sheet. For the convenience of English readers to have a proper understanding, a credit is hereinafter referred to as a "liability" and a debit to as an "asset" in this Sub-Article below]* arising from the origination or reversal of timing differences in the current period.

"Income tax payable for the current period" is calculated based on the taxable income and the current tax rate. The "deferred tax credit or debit arising from the origination or reversal of timing differences in the current period" comprises the amount of income tax payable or deductible in future (computed on the basis of the current tax rate) due to timing differences originating in the current period, and the reversal of any deferred tax debit or credit previously recognized.

Income tax expense for the current period can be set out in a formula as follows:

Income tax expense for the current period = Income tax payable for the current period + Deferred tax liability *[see translator's note above]* in respect of timing differences originating in the current period – Deferred tax asset *[see translator's note above]* in respect of timing differences originating in the current period + Reversal in the current period of a deferred tax asset previously recognized – Reversal in the current period of a deferred tax liability previously recognized.

Deferred tax liability in respect of timing differences originating in the current period = Taxable timing differences in the current period x Current tax rate

Deferred tax asset in respect of timing differences originating in the current period = Deductible timing differences in the current period x Current tax rate

Reversal in the current period of a deferred tax asset previously recognized = Reversed amount of timing differences that reduce taxable income for the current period (that is, deductible timing differences previously recognized, now reversed) x Prior period tax rate used to recognize deferred tax.

Reversal in the current period of a deferred tax liability previously recognized = Reversed amount of timing differences that increase taxable income for the current period (that is, taxable timing differences previously recognized, now reversed) x Prior period tax rate used to recognize deferred tax

(4) Under the liability method, tax expense for a certain period comprises:

1. tax payable for the current period;

2. deferred tax liability or deferred tax asset arising from origination or reversal of timing differences in the current period;

3. adjustments to the book balance of deferred tax liability or deferred tax asset previously recognized, due to a change in tax rate or imposition of new taxes.

Income tax expense for the current period can be set out in a formula as follows:
Income tax expense for the current period = Tax payable for the current period + Deferred tax liability in respect of timing differences originating in the current period – Deferred tax asset in respect of timing differences originating in the current period + Reversal in the current period of deferred tax asset previously recognized – Reversal in the current period of deferred tax liability previously recognized + Reduction of deferred tax asset or increase of deferred tax liability resulting from either a change in the tax rate or imposition of new taxes – Increase of deferred tax asset or decrease of deferred tax liability resulting from either a change in the tax rate or imposition of new taxes.

Increase or decrease in deferred tax asset or liability resulting from either a change in tax rate or imposition of new taxes = The cumulative taxable timing differences (or the cumulative deductible timing differences) x (current tax rate – the tax rate used when deferred tax was previously recognized)

OR = book balance of deferred tax – (the cumulative timing differences for which deferred tax has been recognized x current tax rate)

(5) Under the tax effect accounting method, in view of prudence, a deferred tax debit resulting from timing differences should be recognized and presented as a deferred tax debit only if [it is expected that] there will be sufficient taxable income during the period of their reversal (normally [limited to] three years). Otherwise, the differences should be treated as if they were permanent differences.

Where an enterprise invests in a qualified technological improvement project under the "State Property Policy", a proportion of the amount of domestic equipment acquired for the project that is deductible in the current year's income tax computation (which is limited to the increased amount of income tax over the previous year), and the amount of income tax payable arising from rental of the domestic equipment within the regulated period should be treated as permanent differences. Tax refund arising when an enterprise re-invests the profit after tax in accordance with regulations and the refund of prepaid income tax to an enterprise should be recognized as income tax refund at the time the refunds are actually received. The amount of refunds should reduce the income tax expense of the current year.

Article 108

Generally, an enterprise should calculate its profit on a monthly basis. If an enterprise has difficulties in preparing monthly profit calculations, it may calculate its profit on a quarterly or annual basis.

Article 109

A profit appropriation plan (other than a proposed distribution by way of bonus share issue) proposed by the board of directors or a similar body should first be reflected in the profit appropriation statement for the year reported upon, and then put forward for approval by the shareholders' meeting or a meeting of a similar body. If there is any difference between the approved profit appropriation plan and the proposed plan, the difference should be adjusted to the opening balances of relevant items in the accounting statements of the year reported upon.

Article 110

Profit available for appropriation comprises net profit realized in the current period, the balance of any unappropriated profit at the beginning of the year (or deduct the balance of any accumulated losses at the beginning of the year) and any other balances transferred into profit available for appropriation. Profit available for appropriation should be appropriated in the following order:

(1) set aside any statutory surplus reserve;

(2) set aside any statutory public welfare reserve.

Chapter 7: Profit and Profit Appropriation

A foreign investment enterprise should set aside from net profit the appropriate amounts for statutory reserve, enterprise development reserve, and staff incentive and welfare reserve in accordance with laws and administrative regulations.

If a Sino-foreign co-operative enterprise utilizes its profits to return capital invested back to the investors during the co-operative period according to rules and regulations, or a State-owned industrial enterprise withholding the distribution of certain profit in order to meet the enterprise's working capital requirements according to rules and regulations, such amounts utilized/withheld may also be deducted from profit available for appropriation.

Article 111

Profit available for distribution to the investors is the amount of profit available for appropriation less the statutory surplus reserve and the statutory public welfare reserve. Profit available for distribution to the investors should be appropriated/distributed in the following order:

(1) Dividend on preference shares, being cash dividend payable to the preference shareholders according to the enterprise's profit appropriation plan.

(2) Discretionary surplus reserve, being the discretionary surplus reserve set aside by an enterprise as required.

(3) Dividend on common shares, being cash dividend distributed to common shareholders according to the enterprise's profit appropriation plan. Profits distributed to investors [for an enterprise without issuing shares] should also be accounted for under this item.

(4) Dividends paid to common shareholders by a capitalization issue, being an increase of capital (or share capital) by issue of bonus shares according to the enterprise's profit appropriation plan. Other capitalization of profit by an enterprise should also be accounted for under this item.

The balance of profit available for distribution to investors after making the above appropriation/distributions represents unappropriated profit (or accumulated losses). Unappropriated profits may be appropriated in subsequent periods. Accumulated losses may be offset by profits of subsequent years according to regulations.

Unappropriated profit (or accumulated losses) should be presented in the balance sheet as a separate item under owners' equity.

Chapter 7: Profit and Profit Appropriation

Article 112

An enterprise should account for profit and profit appropriation separately. Separate sub-ledger accounts should be used to account for components of profit and profit appropriation items in detail. Items that should be presented separately in the profit appropriation statement include: statutory surplus reserve, statutory public welfare reserve (or [in the case of foreign investment enterprises] statutory reserve, enterprise development reserve, staff incentive and welfare reserve), dividend on preference shares, appropriation of discretionary surplus reserve, common share dividend, dividend by capitalization issue of capital (or share capital), unappropriated profit (or accumulated losses) at the beginning of the year and unappropriated profit (or accumulated losses) at the end of the period.

Chapter 8: Non-Monetary Transactions

Article 113

A non-monetary transaction is an exchange of non-monetary assets (including an exchange of equity shares for equity shares, but not including a non-monetary transaction involved in a business combination) between the transacting parties. This kind of exchange involves little or no monetary assets. *[Translator note: a small amount of monetary assets in a non-monetary transaction is hereinafter referred to as "boot"]*

Monetary assets are cash held and assets to be received in fixed or determinable amounts of currency. Examples are cash, accounts and notes receivable, and debt investments intended to be held to maturity. Non-monetary assets are assets other than monetary assets. Examples are inventories, fixed assets, intangible assets, equity investments and debt investments not intended to be held to maturity.

In determining whether a transaction involving boot is a non-monetary transaction, the following rules should be followed: An enterprise that receives boot should classify the transaction as a non-monetary transaction if the amount of boot is equal to or lower than 25% of the fair value of the asset surrendered. An enterprise that pays boot should classify the transaction as a non-monetary transaction if the amount of boot is equal to or lower than 25% of the aggregate amount of the fair value of the asset surrendered and boot paid. The formulas are as follows:

For an enterprise that receives boot: Boot received ÷ Fair value of the asset surrendered ≤ 25%

For an enterprise that pays boot: Boot paid ÷ (Boot paid + Fair value of the asset surrendered) ≤ 25%

Article 114

In accounting for a non-monetary transaction, irrespective of whether it is an exchange of an asset for an asset, or exchange of an asset for several assets, or an exchange of several assets for an asset, or an exchange of several assets for several assets, the asset(s) received should be recorded at an amount equal to the carrying amount of the asset(s) surrendered, plus any related tax payments.

If a non-monetary transaction involves boot, the enterprise that pays boot should record the asset received at an amount equal to the aggregate of the carrying amount of the asset surrendered and the boot paid, plus any related tax payments. The enterprise that receives boot should record the asset received at the amount equal to the carrying amount of the asset surrendered less the boot received, plus the amount of gain that should be recognized and any related tax payments. The amount of gain should be recognized in accordance with the following formula:

Gain to be recognized = [1-(Carrying amount of the asset surrendered ÷ Fair value of asset surrendered)] × Boot

Fair value referred to in this System is the amount for which an asset would be exchanged or a liability settled, between two knowledgeable, willing parties in an arm's length transaction.

If the asset received is inventory, the inventory should be recorded in accordance with above prescribed rules and reduced by related deductible input value added tax.

Chapter 8: Non-Monetary Transactions

Article 115

If several assets are received at the same time in a non-monetary transaction [with no boot], each asset received should be recorded at an amount determined by applying that asset's proportion of the total fair value of all assets received to the aggregate of the carrying amounts of all assets surrendered.

Article 116

In an exchange of assets, if the assets received include accounts receivable, it should be accounted for as follows:

(1) If accounts receivable are received in exchange for one or more [non-monetary] assets, the accounts receivable received should be recorded at an amount equal to the carrying amount of the asset(s) surrendered, [except as follows]. If the original carrying amount of the accounts receivable received is greater than the carrying amount of the asset(s) surrendered, the accounts receivable received should be recorded as an amount equal to the original carrying amount of the accounts receivable received. The difference between the recorded amount of accounts receivable and the carrying amount of the asset(s) surrendered should be recognized as an allowance for bad debts.

(2) If accounts receivables and other assets are received in exchange for one or more assets, the enterprise should record the accounts receivable received at the original carrying amount of the accounts receivable received. Each of the other assets received that are not accounts receivable should be recorded at an amount determined by applying that asset's proportion of the total fair value of the other assets received to the amount of (a) the aggregate of the carrying amounts of all assets surrendered plus (b) any related tax payments less (c) the recorded amount of accounts receivable received.

If a non-monetary transaction involves boot and the amount of boot received is lower than the carrying amount of the accounts receivable surrendered, the carrying amount of the accounts receivable surrendered should be reduced by the amount of boot received. The non-monetary transaction should then be accounted for in accordance with the above principles. If the amount of boot received is greater than the carrying amount of the accounts receivable surrendered, the amount of boot received should be reduced by the amount of accounts receivable received. The transaction should then be accounted for in accordance with the accounting principles for non-monetary transactions.

Chapter 9: Foreign Currency Transactions

Article 117

Foreign currency transactions are transactions (including payments, receipts and settlement of receivables and payables) carried out in currencies other than the recording currency.

Article 118

Separate foreign currency accounts should be set up in the ledger to record foreign currency transactions. Foreign currency accounts include cash, bank balances, receivables (such as notes receivable, accounts receivable and prepayments) and payables (such as short-term borrowings, notes payable and accounts payables, deposits received, wages payables and long-term borrowings) denominated in or required to be settled in a foreign currency. Foreign currency accounts should be set up and accounted for separately from non-foreign currency accounts of the same nature.

Article 119

An enterprise should record a foreign currency transaction in the recording currency at the time the foreign currency transaction occurs. Unless otherwise specified, all accounts related to foreign currency transactions should be translated on initial recognition by applying the exchange rate prevailing on the day of the transaction or the exchange rate prevailing at the beginning of the period *[Translator note: "Beginning of the period" refers to the "beginning of the month"]* in which the transaction occurs.

When an enterprise is not able to apply directly one of the three basic exchange rates quoted by the People's Bank of China (the exchange rates of RMB to US dollar, Japanese yen, and HK dollar) on initial recognition of a foreign currency transaction, the following methods should be used:

The exchange rate of RMB to currencies other than US dollar, Yen and HK dollar should be calculated as a cross-rate according to the basic exchange rate of US dollar to RMB and the exchange rate of US dollar to other major foreign currencies quoted in the New York foreign currency market as provided by the State Administration of Foreign Exchange. In applying exchange rates of US dollar to currencies other than RMB, an enterprise should apply directly the exchange rates of the US dollar to other major foreign currencies quoted in the New York foreign currency market as provided by the State Administration of Foreign Exchange.

The exchange rates between currencies other than US dollar and RMB should be calculated as a cross-rate according to the exchange rate of US dollar to other major currencies quoted in the New York foreign currency market as provided by the State Administration of Foreign Exchange.

Article 120

The foreign currency balances of each foreign currency account should be re-translated to the recording currency at the closing rate at the end of each period. The difference between the amount translated at the closing rate and the carrying amount should be treated as exchange gain or loss in the current period. Exchange gains or losses arising in the pre-operating period should be recorded as long term deferred expenses *[Translator note: It is an adjustment to deferred pre-operating expenses.]* Exchange differences arising from borrowings in connection with the construction or acquisition of a fixed asset should be accounted for in accordance with the principles of capitalization of borrowing costs.

Chapter 10: Accounting Adjustments

Article 121

Accounting adjustments are adjustments to the accounting policies or accounting estimates originally applied by the enterprise, and adjustments made as a result of accounting errors or events occurring after the balance sheet date that are required by law, administrative rules or the Accounting System promulgated by the State, or made in accordance with the Accounting System under specific circumstances.

Accounting policies are the specific principles and accounting methods adopted by an enterprise for accounting purposes. Specific principles are the accounting principles adopted by an enterprise in accordance with the uniform Accounting System promulgated by the State that are suitable to the enterprise. Specific accounting treatment is the most suitable accounting treatment chosen by an enterprise from different options of accounting treatments for accounting purpose, for example, specific accounting treatment for long-term investment and bad debts.

Accounting estimates are the judgments made by an enterprise relating to transactions or events, the outcomes of which are uncertain, based on the latest information available. Examples include the estimated useful life and estimated residual value of fixed assets, and the estimated useful life of intangible assets.

Accounting errors are errors in recognition, measurement or recording for accounting purposes.

Events occurring after the balance sheet date are those events that occur between the balance sheet date and the date on which the financial statements are authorized for issue which may indicate the need for adjustment or may require disclosure, including adjusting events and non-adjusting events.

Section 1 Changes in Accounting Policies

Article 122

A change in accounting policy should be made only if one of the following conditions are satisfied:

(1) the change is required by administrative rules or regulations such as laws or accounting standards/system; or

(2) the change will provide more reliable and relevant accounting information about the financial position, operating performance and cash flows of the enterprise.

Article 123

The following are not changes in accounting policies:

(1) the adoption of a new accounting policy for transactions or events occurring in the current period that differ in substance from those previously occurring transactions or events; and

(2) the adoption of a new accounting policy for transactions or events which did not occur previously or that were immaterial.

Chapter 10: Accounting Adjustments

Article 124

Where an enterprise changes its policy in accordance with the requirements of administrative rules or regulations such as laws or accounting standards/system, the change should be accounted for in accordance with the relevant accounting rules promulgated by the State. In the absence of any relevant accounting rules, the change should be applied retrospectively. If an enterprise changes its accounting policy for the purpose of providing more reliable and relevant accounting information, the change should be applied retrospectively.

Retrospective application is a method whereby, for a change in accounting policy in respect of particular transactions or events, the new accounting policy is applied as if it had always been in use from the date that such transactions or events first occurred, and the affected items are adjusted accordingly. Under the retrospective application, the cumulative effect of change in accounting policy should be reported as an adjustment to the opening balance of retained earnings. The opening balances of other affected items of the accounting statements should also be adjusted and there is no requirement to reissue prior years' financial statements.

Article 125

The cumulative effect of a change in accounting policy is the difference between the adjusted opening balance of retained earnings in the period of change resulting from the retrospective application of change in accounting policy and the opening balance of retained earnings as originally stated. The cumulative effect of a change in accounting policy is the difference between (a) the adjusted opening balance of retained earnings in the period of change on the assumption that the new accounting policy is applied to the events and transactions from the date of origin of such items; and (b) the amount originally stated. The cumulative effect of a change in accounting policies prescribed in this System refers to the cumulative effect on net profit or loss and the cumulative effect on the amount of profit appropriation and undistributed profit (excluding distributed profit or dividend) as a result of the change in accounting policy. Retained earnings include statutory surplus reserve, statutory public welfare reserve, discretionary surplus reserve and unappropriated profit (in the case of a foreign investment enterprise, retained earnings also include statutory reserve and enterprise development reserve). The above mentioned cumulative effect may normally be computed as follows:

Step 1: Re-calculate the amounts of affected transactions or events in prior period in accordance with the new accounting policy;

Step 2: Quantify the resulting difference [in pre-tax profit or loss] in applying the two accounting policies;

Step 3: Compute the amount of profit tax effect on the difference (if profit tax need to be adjusted).

Step 4: Determine the after tax amount of the difference for each of the prior periods.

Step 5: Quantify the cumulative effect of the change in accounting policy.

If the cumulative effect of a change in accounting policy cannot be reasonably determined, the change should be applied prospectively. Prospective application is a method whereby, for a change in accounting policy in respect of particular transactions or events, the new accounting policy is applied to the transactions or events occurring during the period of change and in subsequent periods. Under the prospective application, the cumulative effect of a change in accounting policy is not required to be quantified and there is no requirement to reissue prior years' accounting statements. The amounts recorded in the accounting records and accounting statements of an enterprise remain the same on the date of change as they are originally stated. Prior years' results would not be affected by the change. An enterprise should apply the new accounting policy to existing balances as from the date of the change.

Article 126

In preparing comparative accounting statements that include comparative figures, a change in accounting policy during the periods presented should be adjusted against the net profit or loss in each period presented and other affected items as if the new accounting policy had always been applied. Any cumulative effect of a change in accounting policy in the periods prior to the comparative periods included in the comparative accounting statements should be reported as an adjustment to the opening balance of retained earnings in the earliest period presented in the comparative accounting statements. The figures of other affected items of the comparative accounting statements should also be adjusted.

Article 127

An enterprise should disclose in the notes to the accounting statements the details of any change in accounting policy, together with the reasons therefor, the amount of the effect resulting from the change in accounting policy, or the reasons that the cumulative effect of change in accounting policy cannot be reasonably determined, if applicable.

Section 2 Changes in Accounting Estimates

Article 128

As a result of the uncertainties inherent in business activities, many accounting statement items cannot be measured with precision but can only be estimated. An estimate may have to be revised if changes occur regarding the basis on which the estimate was made or as a result of new information being obtained, more experience being gathered or subsequent developments.

Article 129

The cumulative effect of change in accounting estimate is not required to be quantified and there is no requirement to reissue prior years' accounting statements. New accounting estimates should be applied to transactions or events occurring in the period of the change and future periods.

Chapter 10: Accounting Adjustments

Article 130

When a change in an accounting estimate affects only the period of the change, the effect of the change should be included in the period of the change under the same classification as was used previously for the estimate. When a change in an accounting estimate affects both the period of the change and future periods, the effect of the change should be included in the period of the change and in the future periods, under the same classification as was used previously for the estimate.

Article 131

When it is difficult to distinguish between a change in accounting policy and a change in accounting estimate, the change should be accounted for as a change in accounting estimate.

Article 132

An enterprise should disclose in the notes to the accounting statements the details of any change in accounting estimates together with the reasons therefor, the amount of the effect resulting from the change in accounting estimates, or the reasons that the effect of the change in accounting estimates cannot be reasonably determined, if applicable.

Section 3 Corrections of Accounting Errors

Article 133

Accounting errors discovered in the current period should be accounted for in accordance with the following principles:

(1) accounting errors relating to current period and discovered in the current period should be adjusted against relevant items in the current period;

(2) insignificant accounting errors discovered in the current period that affect the profit or loss arising in prior periods should be directly reflected in the net profit or loss for the current period together with an adjustment to any other relevant items; If there is no effect on the profit or loss, relevant items of the current period which are affected should be adjusted.

Significant accounting errors are accounting errors discovered by an enterprise that would cause accounting statements previously issued to be no longer reliable. In general, significant accounting errors are errors with a comparatively large amount. If an error accounts for 10% or more of the total transaction amount of similar types of transactions, the amount is generally considered to be comparatively large.

(3) significant accounting errors discovered in the current period that affect the profit or loss in prior periods should be adjusted to the opening balance of retained earnings. The opening balance of other related items in the accounting statements should also be adjusted. If there is no effect on the profit or loss, the opening balance of related items in the accounting statements should be adjusted.

(4) accounting errors of the reporting year and insignificant errors related to prior years discovered between the balance sheet date and the date on which the financial and accounting report is authorized for issue to the public should be accounted for as adjusting events in accordance with the treatments of events occurring after the balance sheet date.

Significant accounting errors related to prior year discovered between the balance sheet date and the date on which the financial and accounting report is authorized for issue should be adjusted against relevant items in prior year.

Article 134

In preparing accounting statements which include comparative figures, any significant accounting errors related to the periods presented should be adjusted against the net profit or loss in each period presented and other affected items. For significant accounting errors related to periods prior to those included in the accounting statements, adjustments should be made against the opening balance of retained earnings in the earliest period presented in the accounting statements. The figures of other affected items of the accounting statements should also be adjusted.

Article 135

An enterprise should disclose in the notes to the accounting statements the details of any significant accounting error, and the amount of correction.

Article 136

Improper manipulation of accounting policies and accounting estimates by an enterprise, and improper changes of policies and estimates should be treated as significant accounting errors and amended accordingly.

Section 4 Events Occurring After the Balance Sheet Date

Article 137

Events occurring after the balance sheet date that provide new or additional evidence to assist with the estimation of amounts relating to conditions existing at the balance sheet date should be regarded as adjusting events. Revenues, expenses, assets, liabilities and owners' equity reflected at the balance sheet date should be adjusted accordingly. Examples of adjusting events include:

(1) confirmation of impairment of assets;

(2) sales returns; and

(3) confirmation of claim receivable or payable.

A profit appropriation provided for in a profit appropriation plan that is formulated by a meeting of the board of directors or managers/factory managers or a similar body after the balance sheet date in respect of the period covered by the financial and accounting report should be regarded as an adjusting event, with the exception that a stock dividend (or an increase in capital by capitalizing retained profits) included in the profit appropriation plan should be regarded as a non-adjusting event.

Article 138

Adjusting events occurring after the balance sheet date should be accounted for in accordance with relevant accounting treatments in the same way as if the events had occurred in the period covered by the accounting statements, and the accounting statements prepared up to the balance sheet date should be adjusted accordingly. Accounting statements referred to in this Article include a balance sheet, an income statement and relevant supplementary statements, and the details of supplementary information of the cash flow statement (excluding the cash flow statement itself). Adjusting events occurring after the balance sheet date should be accounted for in the ledger as follows:

(1) events involving adjustments to profit or loss should be accounted for through the "Prior year profit or loss adjustments" account. Adjustments to increase the profit or reduce the loss of prior year, and the corresponding reduction of profit tax should be credited to "Prior year profit or loss adjustments" account. Adjustments to reduce the profit or increase the loss of prior year, and the corresponding increase in income tax should be debited to "Prior year profit or loss adjustments" account. The debit or credit balance of "Prior year profit or loss adjustments" account should then be transferred to "Profit appropriation - unappropriated profits" account.

(2) events involving adjustments to profit appropriation should be accounted for through the "Profit appropriation - unappropriated profits" account directly.

(3) events that do not involve adjustments to profit or loss and profit appropriation should be adjusted against relevant accounts.

(4) after preparing the above accounting adjustments, the following relevant figures in the accounting statements should also be adjusted:

1. figures of the relevant items in the accounting statements for the period ending on the balance sheet date;

2. opening balances of relevant items in the accounting statements prepared for the current period;

3. prior year figures of relevant items should be adjusted if comparative accounting statements are provided;

4. after preparing the above adjustments, relevant figures in the notes to the accounting statements should also be adjusted if the adjustments affect the content of the notes to the accounting statements.

Article 139

Events occurring or existing after the balance sheet date that do not affect the conditions existing at the balance sheet date, but in respect of which the omission of a disclosure would affect the ability of the users of the financial statements to make proper evaluation and decisions, should be regarded as non-adjusting events and disclosed in the notes to the accounting statements. Examples of non-adjusting events include:

(1) issues of shares and bonds;

(2) a substantial investment in an enterprise;

(3) losses of assets as a result of a natural disaster; and

(4) significant changes in rates of foreign exchange.

Details of non-adjusting events should be provided together with an estimate of the effect on the financial position and operation results in the notes to accounting statements. If it is impracticable to make an estimate, the reason should be disclosed.

Chapter 11: Contingencies

Article 140

A contingency is a condition that arises from past transactions or events, the outcome of which will be confirmed only by the occurrence or non-occurrence of uncertain future events.

A contingent liability is a possible obligation that arises from past transactions or events and whose existence will be confirmed only by the occurrence or non-occurrence of uncertain future events; or is a present obligation that arises from past transactions or events but is not recognized because it is not probable that an outflow of economic benefits from the enterprise will be required to settle the obligation or the amount of the obligation cannot be measured reliably.

A contingent asset is a possible asset that arises from past transactions or events and whose existence will be confirmed only by the occurrence or non-occurrence of uncertain future events.

Article 141

An enterprise should recognize the related obligation of a contingency as a liability when the obligation meets the following conditions:

(1) that obligation is a present obligation of the enterprise;

(2) it is probable that an outflow of economic benefits from the enterprise will be required to settle the obligation; and

(3) a reliable estimate can be made of the amount of the obligation.

A liability that meets the above recognition criteria should be separately presented in the balance sheet.

Article 142

The amount of a liability that meets the above recognition criteria should be the best estimate of the expenditure required to settle the liability. Where there is a range of [possible] amounts of expenditure required to settle the liability, the best estimate should be determined according to the average of the lower and upper limit of the range. Where there is not a range of [possible] amounts of expenditure required to settle the liability, the best estimate should be determined in accordance with the following methods:

(1) where the contingency involves a single item, the best estimate should be determined according to the most likely outcome;

(2) where the contingency involves several items, the best estimate should be determined by weighting all possible outcomes by their associated probabilities of occurrence.

Chapter 11: Contingencies

Article 143

Where some or all of the expenditure required to settle a liability that meet the above recognition criteria is expected to be reimbursed by a third party or other party, the reimbursement should be separately recognized as an asset when, and only when, it is virtually certain that the reimbursement will be received. The amount recognized for the reimbursement should not exceed the carrying amount of the liability recognized.

An asset that meets the above recognition criteria should be separately presented in the balance sheet.

Article 144

An enterprise should not recognize a contingent liability or a contingent asset.

Article 145

An enterprise should disclose the underlying causes of the following contingent liabilities, the estimated expected financial effects (if it is impracticable to estimate the effect, the reasons should be stated) and the possibility of any reimbursement, in the notes to the accounting statements:

(1) contingent liabilities arising fromdiscounted commercial bills of exchange under acceptance;

(2) contingent liabilities arising from pending litigation or arbitration;

(3) contingent liabilities arising from guarantees provided for the debts of other enterprises; and

(4) other contingent liabilities (excluding those contingent liabilities of which the possibility of any outflow of economic benefits is remote).

Article 146

In general, contingent assets should not be disclosed in the notes to the accounting statements. However, if it is probable that a contingent asset will give rise to an inflow of economic benefits to the enterprise, the cause of that contingent asset should be disclosed in the notes to the accounting statements, and, where practicable, the estimated expected financial effect.

In the case of a pending litigation or arbitration, if disclosure of all or part of the information required by this section is expected to prejudice seriously the position of the enterprise, an enterprise need not disclose the information, but it should disclose the underlying causes of the pending litigation or arbitration.

Chapter 12: Related Party Relationships and Transactions

Article 147

If a party has the power to, directly or indirectly, control, jointly control or exercise significant influence over the financial and operating policy decisions of another party, there is a related party relationship between these parties. If two or more parties are subject to control from the same party, there is also a related party relationship between the controlled parties. The most common situations where a related party relationship exists are:

(1) Enterprises that, directly or indirectly, control, or are controlled by, the reporting enterprise. A related party relationship also exists where two or more enterprises are subject to control from the same enterprise (Examples include parent companies, subsidiaries and fellow subsidiaries).

A parent company is an enterprise that has direct or indirect control over other enterprise. A subsidiary is an enterprise that is controlled by a parent company.

(2) Joint ventures
A joint venture is an enterprise the business activities of which are, as contractually agreed, jointly controlled by two or more investing parties.

(3) Associated enterprises.
An associated enterprise is an enterprise over which an investor has significant influence and which is neither a subsidiary nor a joint venture of that investor.

(4) Principal individual investors, key management personnel or close family members of such individuals.

A principal individual investor is an individual investor who controls, directly or indirectly, 10% or more of the voting capital of an enterprise. Key management personnel are those personnel who have the authority and responsibility for planning, directing and controlling the activities of an enterprise. Close family members of an individual are those family members who may influence, or be influenced by, that individual in dealing with transactions with an enterprise.

(5) Other enterprises directly controlled by any principal individual investor, or key management personnel, or the close family members of such individuals.

State-controlled enterprises should not be related parties simply because they are subject to control from the State. However, where relationships referred to in paragraphs (1) to (3) exist between these enterprises, or where they are directly controlled by the same key management personnel or their close family members in accordance with paragraph (5), they should be regarded as related parties.

Chapter 12: Related Party Relationships and Transactions

Article 148

Where a control relationship exists between related parties which are enterprises, the following should be disclosed in the notes to the accounting statements, whether or not there have been transactions between the enterprises: the nature or type of business entity, the name, the legal representative, the place of registration, amount of registered capital and changes therein, the principal business, the proportion of shareholding and changes therein of the related enterprises.

Article 149

Where there have been transactions between an enterprise and its related parties, the reporting enterprise should disclose the nature of the related party relationships, the types of transactions and the essential elements of the transactions in the notes to the accounting statements. Such essential elements normally include the amounts of the transactions or the corresponding proportions, the amounts of outstanding items or the corresponding proportions and the pricing policies (including those transactions where no amount or only nominal amounts have been charged).

Related party transactions should be disclosed separately for the related parties and the types of the transactions involved; related party transactions of the same type may be disclosed in aggregate when it does not affect the proper understanding of the users of the financial and accounting reports.

Article 150

No disclosure is required for the following related party transactions:

(1) the disclosure in consolidated accounting statements of transactions between members of the group included in the consolidated accounting statements;

(2) the disclosure of related party transactions in the accounting statements of a parent company which are provided together with the consolidated accounting statements.

Chapter 13: Financial and Accounting Reports

Article 151

An enterprise should prepare and publish *[Translator note: "Publish" generally means providing the report to the relevant government departments or authorities, the investors etc. Reports of listed enterprises will also be made available to the general public]* a true and complete financial and accounting report in accordance with "Financial and Accounting Reporting Regulations for Business Enterprises".

Article 152

The financial and accounting reports of an enterprise can be classified as the annual report, the half-yearly report, quarterly reports and monthly reports. Monthly and quarterly reports are published by an enterprise after the end of each month and each quarter, respectively. The half-yearly report is published after the end of the first 6 months of each fiscal year. The annual report is published after the end of a fiscal year.

Half-yearly, quarterly, and monthly financial and accounting reports are collectively referred to as interim financial and accounting reports in this System.

Article 153

A financial and accounting report of an enterprise comprises the accounting statements, the notes to the accounting statements, and a financial condition explanatory memorandum *[Translator note: This is a memorandum prepared by the management similar to the Management Discussion and Analysis. (some enterprises are not required to publish a financial condition explanatory memorandum)]*. The content of published financial and accounting reports, the type and format of accounting statements, and the main content of the notes to the accounting statements are prescribed by this System. An enterprise can decide the form and content of any accounting statements used for its own internal managerial purposes.

Quarterly and monthly interim financial and accounting reports usually include accounting statements only (except there are specific requirements under the uniform accounting system promulgated by the State). *[Translator note: Listed enterprises may be required by accounting standards or listing rules to include certain notes in their quarterly or monthly reports.]*

Notes to the accounting statements of a half-yearly interim financial and accounting report should disclose all significant events such as the disposal of a subsidiary. Events occurring or contingencies arising after the balance sheet date but before the date on which the half-yearly interim financial and accounting report is issued need not be recognized in or disclosed in that interim financial and accounting report unless the event is very significant.

Article 154

Accounting statements to be included in a published financial and accounting report are:

(1) a balance sheet;

(2) an income statement;

(3) a cash flow statement;

(4) a statement of provision for impairment of assets;

(5) a profit appropriation statement;

(6) a statement of changes in owners' equity;

(7) a statement of segmental information; and

(8) other relevant supplementary statements.

Article 155

Notes to the accounting statements [,if required] should at least comprise the following:

(1) an explanation of any non-compliance with basic accounting presumptions;

(2) details of significant accounting policies and accounting estimates;

(3) an explanation of changes in significant accounting policies and estimates;

(4) details of contingencies and events occurring after the balance sheet date;

(5) disclosures of related party relationships and transactions;

(6) details of the transfer or disposal of significant assets;

(7) details of business combinations and de-mergers;

(8) detailed information about significant items in the accounting statements; and

(9) other disclosures that are necessary to enable users to understand and analyze the accounting statements.

Article 156

The financial condition explanatory memorandum should at least cover the following areas:

(1) general information about the production and operation of the enterprise;

(2) information about financial performance and profit appropriation;

(3) information about financing activities and liquidity; and

(4) other events that have a material impact on the financial position, operating results, and cash flows of the enterprise.

Article 157

Monthly interim financial and accounting reports should be published within 6 days after the end of the month (deadlines will be extended to take into account of public holidays). Quarterly interim financial and accounting reports should be published within 15 days after the end of the quarter. Half-year interim financial and accounting reports should be published within 60 days (that is, 2 consecutive months) after the end of the interim period. Annual financial and accounting reports should be published within 4 months after the end of the fiscal year.

Financial reports should be reported in RMB "Yuan" [one RMB dollar] and up to 2 decimal places.

Article 158

An enterprise should prepare consolidated accounting statements if: (a) it holds directly more than 50% (not including 50%) of the registered capital of an investee enterprise; or (b) it holds directly 50% or less of the registered capital of an investee enterprise but, in substance, has control over the investee enterprise. In preparing consolidated accounting statements, an enterprise should comply with the principles and methods relating to compilation of consolidated accounting statements prescribed in the uniform accounting system promulgated by the State.

In preparing consolidated accounting statements, an enterprise should consolidate the assets, liabilities, income, expenses, and profits of its joint venture enterprises using proportionate consolidation method.

Article 159

Accounting statements published by an enterprise should be paginated, bound with a covering page, and stamped with the enterprise's official seal. The covering page should state the name of the enterprise, the uniform code of the enterprise, the legal form, the address, the financial year or month reported on, and the date of issue, and should be signed and stamped with the seal of the person in charge of the enterprise, the person in charge of accountancy work, and the person in charge of the accounting department. If a chief accountant is appointed *[Translator note: This means the chief accountant as defined in Chief Accountant Law and only large State-owned enterprises are required to appoint a chief accountant.]*, the accounting statements should also be signed and stamped with the seal of the chief accountant.

Chapter 14: Supplementary Provision

Article 160

This System becomes operative as from 1 January 2001.