Financial Management and Governance Issues in the People’s Republic of China

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Foreword

This report describes financial management and governance arrangements in the People’s Republic of China, identifies deficiencies in those arrangements, and presents recommendations to address those deficiencies. For the purposes of this study, financial management and governance arrangements are narrowly defined as being accounting and auditing arrangements and practices.

The report was prepared for the Asian Development Bank by Barry Reid (International Consultant) with overall guidance from Francis B. Narayan (Lead Financial Specialist, ADB) under Regional Technical Assistance (RETA) 5877 – Strengthening Financial Management and Governance in Selected Developing Member Countries. Zhang (Annie) Ran provided able research assistance. The contents of the draft report were discussed and debated with representatives from the Government, the private sector, and international organizations at a workshop that was held in Beijing on 14 August 2000. The issues and recommendations were further discussed at an international conference at ADB headquarters in Manila from 16 - 18 October 2000.

This report should be read in conjunction with the Summary Report, which identifies and examines selected issues in relation to financial management and governance.¹

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General of the Chinese Institute of Certified Public Accountants) for his support throughout the study.

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( as at 3 November 2000 )

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The currency is the Renminbi, while the currency unit is the Yuan. The exchange rate of the Yuan is determined under a managed floating exchange rate system.

**Abbreviations**

- ADB: Asian Development Bank
- ARD: Accounting Regulatory Department (Ministry of Finance)
- AusAID: Australian Agency for International Development
- CAPA: Confederation of Asian and Pacific Accountants
- CASC: China Accounting Standards Committee
- CICPA: Chinese Institute of Certified Public Accountants
- CIIA: China Institute of Internal Auditing
- CN AO: China National Audit Office
- CP A: Certified Public Accountant
- CPE: Continuing Professional Education
- CSRC: China Securities Regulatory Commission
- FFAAD: Foreign Funds Application Audit Department (CNAO)
- GDP: Gross Domestic Product
- IAS: International Accounting Standard
- IFAC: International Federation of Accountants
- IMF: International Monetary Fund
- JICA: Japan International Cooperation Agency
- MOF: Ministry of Finance
- NAI: National Accounting Institute
- NPC: National People's Congress
- PBC: People's Bank of China
- RETA: Regional Technical Assistance
- SOE: State-owned Enterprise
- TA: Technical Assistance
- UNDP: United Nations Development Program

**Notes**

(i) The financial year of all organizations, including the Government, ends on 31 December.

(ii) In this report, $ refers to US dollars.
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Executive Summary

Background

On 1 October 1949, Mao Zedong proclaimed the People's Republic of China (PRC) to an audience of 500,000 in Tiananmen Square. Shortly afterwards, central planning was introduced. Beginning in late 1978, the Chinese leadership began to move the PRC from a centrally-planned economy to a more market-oriented economy. To this end the authorities switched to a system of household responsibility in agriculture in place of the old collectivization, increased the authority of local officials and plant managers in industry, permitted a wide variety of small-scale enterprise in services and light manufacturing, and opened the economy to increased foreign trade and investment.

The PRC has made tremendous progress in poverty reduction, particularly over the last two decades. Twenty years ago, it was among the world's poorest countries, with 80 percent of the population living on incomes of less than $1 a day and only a third of all adults able to read or write. In the 17 years from the launching of the PRC's economic reform program in 1978, the transition from a command to a market-based economy, helped fuel a remarkable average growth in GDP of 8 percent a year. Since then, growth has remained relatively strong and incomes have generally continued to rise. Now, only about 7 percent of the population between 15 and 25 years old is illiterate, and the PRC's high life expectancy and low infant mortality rates are envied by much richer nations. The PRC has made great strides in improving social welfare. Consumption has more than doubled and the poverty rate has declined, as 200 million Chinese living in absolute poverty have been raised above the minimum poverty line.

Prudent macroeconomic policy aided the PRC in adjusting to the Asian crisis. In 1999, growth slowed slightly and prospects are that a rate lower than the trend in the 1990s can be sustained in the medium term. The challenges will be continuing the reform process of opening the economy, improving state sector efficiency, addressing unemployment issues, and developing a legal and regulatory framework essential for efficient functioning of a market economy.

Developments and Challenges

The PRC had public accounting firms and an accountancy profession before the introduction of central planning. The Soviet accounting system, which catered to the needs of central planning, was adopted in
the 1950s. The system provided statistical information, and emphasized standardization and uniformity so that information could be compared across sectors and industries. Detailed instructions replaced professional judgment in the accounts-preparation process and public accounting firms and the accountancy profession were unnecessary.

The PRC’s 1979 decision to align accounting practices with the needs of a mixed-market economy posed a number of challenges. First, bookkeepers numbered in the tens of millions but there were no qualified Certified Public Accountants (CPAs), let alone a professional accounting body. Second, financial information on the performance and position of organizations was not publicly available. In any case, this information did not meet international standards nor did it cater to the needs of investors or lenders. Third, the users of financial information (investors and creditors) were unfamiliar with what they should demand from organizations. Fourth, financial information was not independently verified (audited) to international standards. Fifth, the entire legal framework was geared to central planning and specified exactly what information should be produced, how it should be produced, and to whom it should be provided. Finally, the regulatory entities that generally exist in market economies to oversee financial disclosure practices, such as securities exchange commissions, did not exist.

Objectives and Responses

The PRC’s continuing accounting reforms have three objectives. First, to standardize and rationalize financial reporting – this is expected to gradually improve the efficiency of business enterprises through associated improvements to financial management and control systems. Second, to transit from the Soviet accounting model to the western accounting model – the adoption of the western accounting model is expected to facilitate foreign direct investment in the PRC. Third, to gradually give business enterprises more discretion to design their own internal accounting and financial systems.

In the two decades since 1979, the PRC has made enormous strides in terms of developing an accounting infrastructure suitable to the needs of a market economy. The first accounting firm was established in 1981 as a subsidiary of a government organization – there are now around 4,800 accounting firms. In 1985, the first Accounting Law was enacted which set out accounting responsibilities and procedures for state-owned enterprises. The Chinese Institute of Certified Public
EXECUTIVE SUMMARY

Accountants (CICPA) was established in 1988 – it now has 135,000 members. The first IAS-based accounting standard was promulgated in 1992. In 1997, a vigorous ‘Rectification Campaign’ was conducted to improve professional practices and ethics. By the campaign’s end in 1999, 12,700 individual CPAs and 580 CPA firms had been forced from the profession.

Accounting and Auditing in the People’s Republic of China

The ‘Chinese accounting system’ is governed by the recently amended Accounting Law 1985, which sets out accounting arrangements, responsibilities and procedures. The Accounting Law serves as the ‘constitution’ for the school of accounting regulations and defines the accounting and reporting practices for all public and private sector organizations. Furthermore, ‘Uniform Accounting Systems’ and ‘Accounting Standards for Businesses’ determine accounting and financial reporting practices. The Uniform Accounting Systems prescribe charts of account, reporting formats and detailed accounting instructions. The ‘Accounting Standards for Businesses’ are based directly on IASs. All organizations use double-entry bookkeeping and prepare balance sheets. In these respects, PRC government accounting is more advanced than most developed countries.

The Audit Law 1994 governs auditing in the PRC and defines the basic principles for government auditing supervision, government audit institutions and auditors, the responsibilities and powers of audit institutions, audit procedures, and the legal liability of auditors. The PRC had no independent audit institutions from 1949 until December 1982, when the National People’s Congress adopted a resolution to establish an auditing system in the PRC. Because of this resolution, the China National Audit Office (CNAO) was established in September 1983. The Auditor General who is a member of the State Council heads the CNAO. The CNAO audits public sector organizations (including many State-owned enterprises). It is also responsible for leading, developing, and supervising the auditing profession – it does not conduct financial attest audits.

After a 30-year hiatus, the first public accounting firm was established in the PRC in 1981. Much has happened in the ensuing 20 years – the PRC now has a thriving CPA profession. In the past two years, domestic accounting firm mergers have been actively encouraged. With the removal of restrictions – firms were previously legally allowed to only cover a single specific region – a number of accounting firms have
merged. The Big Five international accounting firms are all present in the PRC.

**Professional Infrastructure**

The Chinese Institute of Certified Public Accountants (CICPA) was established in 1988 and is now one of the world’s largest professional accounting bodies, with around 135,000 individual members and 4,800 group members (CPA firms). While the Institute is nominally an independent organization, it is under the direct supervision and direction of the Ministry of Finance (major policies must be approved by the MOF). The Certified Public Accountants (CPA) Law 1993 governs its activities. Since 1991, aspiring CICPA members must have an approved accounting degree, pass a uniform CPA examination, and demonstrate appropriate practical experience to gain membership. Some 530,000 candidates sat the examination in 2000, making it one of the world’s largest practising-certificate examinations. CICPA members must undertake Continuing Professional Education to remain a member.

**Accounting and Auditing Standards**

In the 1950s, the PRC adopted a highly centralized administrative system from the Soviet Union (uniform accounting systems). In the early 1990s, it was decided that a series of basic and specific accounting standards that would be consistent with international accounting practices and that would cater to Chinese realities should be developed. In 1992, the Ministry of Finance issued the first of the PRC’s new IAS-based accounting standards – Accounting Standards for Business Enterprises – No. 1 Fundamental Accounting Standards. A further ten standards have been issued since and more are on the drawing board. With the release of the first new accounting standard, the Ministry of Finance published a series of new uniform accounting systems for the major economic sectors. The Ministry of Finance is responsible for developing accounting standards but does so on advice from the China Accounting Standards Committee (CASC) which has seven members drawn from various backgrounds. With one exception, there are no significant differences between the PRC’s accounting standards and IAS. The significant difference involves the requirement to agree; divergences from regulations (to comply with relevant accounting standards), and provisions for damaged or obsolete inventories, with the relevant authorities.
In the past six years, CICPA has developed a series of Independent Auditing Standards for the private sector, which are consistent with International Standards on Auditing. The CNAO has issued 38 Government Auditing Standards - these are currently being reviewed with ADB assistance.

**Education and Training**

Before 1978, the teaching methods for accounting was virtually a replica of the Soviet system. The accounting major was reintroduced into universities and colleges in 1978. A new accounting curriculum was introduced in the late 1980s - changes involved the introduction of core courses covering: accounting principles, intermediate financial accounting, advanced financial accounting, management accounting, cost accounting, financial management, and auditing. New textbooks were prepared and teaching materials were updated to reflect the new curriculum. Accounting academics recently examined accounting education and identified the following systemic weaknesses which, in the opinion of workshop attendees, are overstated: poorly-defined accounting education objectives, poor design of accounting majors, a weak curriculum system that does not fully reflect the needs of a mixed-market economy, poor compilation of textbooks, and lack of teaching consistency.

The 500 higher-education institutions that offer accounting majors include 23 universities and colleges that provide specialized CPA-oriented education. These institutions produced 1,500 graduates in 1999. In addition, three more schools specializing in CPA education are to be opened in Beijing (National Accounting Institute), Shanghai (Shanghai Accounting Institute), and Guangdong in the next year. A rudimentary estimate, based on an average of ten teaching staff at each of the 500 institutions teaching undergraduate accounting, is that the PRC has about 5,000 accounting teachers (higher education). A ‘self-sponsored’ training approach is taken to their development. Accounting professors and lecturers do not however, receive formal training. For instance, the target-training group for the National Accounting Institute does not include accountancy professors and lecturers.

**Government Budgeting and Accounting**

While the PRC’s fiscal deficit has remained comparatively low in the past 20 years, there is increasing concern about public finance arrangements. These concerns center on the use of extra-budgetary
funds (surtaxes, levies, and user charges accruing to government and administrative units) and the growing identification of public sector wastage and mismanagement. In recognition of these issues, the Ministry of Finance, with support from the United Nations Development Program (UNDP), the World Bank and the International Monetary Fund (IMF), is currently examining options for budgetary reform with the intention of designing a comprehensive program to overhaul the PRC’s budget procedures.

The aggregate budget is prepared on a cash basis – the Government also prepares a consolidated balance sheet, which includes information on the level and composition of debt. Individual budget units use modified cash accounting. Their reports include cash information, which is consolidated for aggregate budgeting and reporting requirements. Not-for-profit organizations (e.g., schools, kindergartens, hospitals) have recently moved from cash accounting to a modified form of accrual accounting. While there are no firm plans for government organizations to report in accordance with International Standards, a research study into the feasibility of developing accounting standards for government organizations will be conducted as part of the World Bank-supported Accounting Reform Project.

Donor Assistance

The ADB is supporting broad governance activities through the technical assistance program. Directly relevant projects include:

- TA No. 1483-PRC: Audit Administration of the PRC ($600,000: 1991–1995). This TA improved the CNAO’s capacity to audit externally-assisted projects.
- TA No. 3103-PRC: Strengthening the Government Audit System ($700,000: 1999–2001). This TA is providing assistance to help strengthen the Government’s audit system to conform to the requirements of the Auditing Law 1994 and, as far as practicable, international standards on auditing.
- Pipeline 2001: Strengthening the Accounting Profession ($600,000: 2001). The recommendations from this study will be considered when the details of this TA are decided.

The World Bank has been the major provider of external assistance in relation to the development of accounting and auditing arrangements. Projects include:
EXECUTIVE SUMMARY


- Fiscal Technical Assistance Project ($50 million: 1995–2001). Despite the 1995 starting date, very little was accomplished under this project until April 2000, with completion of a comprehensive Public Expenditure Management Review, by a World Bank team. A plan to reform and computerize government budgeting and accounting systems and procedures is currently being developed – the plan is drawing on the findings of the PEM, and will be implemented using the funding set aside in the Fiscal Technical Assistance Project.

- Technical Assistance to the CNAO ($487,000: 1997–2000). Technical assistance has been provided to the Foreign Funds Application Audit Department (FFAAD) of the CNAO to: establish a management information system that will enable the FFAAD to efficiently and accurately collect and distribute audit data among its nationwide network of offices; familiarize senior FFAAD management with the experiences of Supreme Audit Institutions in performance auditing; enhance the skills and knowledge of selected senior FFAAD auditors in specialized areas of accounting and auditing practice with an emphasis on performance auditing, and establish a core training program to develop the knowledge and skills of auditors in areas of modern audit theory and practices.

- Accounting Reform and Development Project ($33 million: 1999–2004). This project is building upon the FSTA project – its objectives are to further strengthen the caliber and training of members of the accounting profession and to develop and promulgate additional accounting standards. The project has three components: (i) to establish the National Accounting Institute which will be a Beijing-located residential facility that can accommodate up to 1,500 students at one time; (ii) to strengthen CICPA through the provision of computers, software and other essential equipment; and (iii) to develop and disseminate further accounting standards.

  The IMF and the UNDP are working together with the World Bank on public expenditure management and treasury management. AusAID (Australia) is supporting a five-year, $11 million, capacity-building program to help strengthen the public sector. The program has supported Australian training for nine middle-ranking managers from
the CNAO on state-owned enterprises auditing. The suitability of computerized audit approaches was also investigated. A key output will be a Financial Statements Audit procedures manual for conducting audits of SOEs. Multimedia and information technology specialists have worked with CNAO who will produce highly interesting inter-active training material for CNAO's auditors conveying the content of this manual. Canadian International Development Agency (CIDA) has provided training support to the CNAO. The German Technical Assistance Agency (GTZ) is providing ongoing support to the CNAO, in particular, to the Continuing Education Centers.
I. Introduction

1. Study Background

The 1997 financial crisis in Asia exposed structural weaknesses in the banking and corporate sectors of affected countries owing largely to poor governance, lack of transparency, and weak supervision and regulation.

The Asian Development Bank (ADB) has been taking a number of initiatives to assist Developing Member Countries (DMCs) in overcoming these structural problems. The focus on improved governance includes enhancing the effectiveness of public administration and development management at the sector level and in national institutions in the DMCs. Where appropriate, institutional development of the local and provincial agencies and the private sector is also covered. A sound regulatory financial framework and its enforcement, capable institutions, skilled human resources, and effective monitoring and supervision are important prerequisites to an efficient financial structure.

Regional Technical Assistance (RETA) No. 5877 - Strengthening Financial Management and Governance in Selected DMCs - was approved by ADB for the purpose of carrying out initial studies to identify gaps and weaknesses in financial management and governance and to recommend courses of action to overcome these problems.

2. Objectives

ADB has demonstrated its stand on the importance of good governance, through effective financial management, for sustained economic development. This RETA involved a diagnostic review of the existing accounting and auditing support and standards available in the selected DMCs. After carrying out this diagnostic review, the study assessed the need for assistance to improve the current situation. Objectives were to:

(i) assess the capability and capacity within each country to provide efficient and effective accounting and auditing support to meet international standards and best practices and address the issue of training and capacity enhancement

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determine the existing accounting and auditing standards of each country

(iii) assess the degree of deviation from International Accounting and Auditing Standards (IAAS) while identifying weaknesses and possible corrective options

(iv) discuss the fieldwork findings and introduce the concepts of the international standards through workshops

(v) develop reference materials for potential users of the IAAS, and

(vi) determine the level and type of assistance needed by each country in order to provide acceptable accounting and auditing support to the private and public sectors.

3. Scope

The RETA involved an in-depth study of the key issues relating to accounting and auditing support in the selected DMCs, identified gaps and weaknesses that need to be addressed to improve accounting and auditing support, and developed assistance programs in collaboration with other donors to rectify the identified weaknesses. The People's Republic of China (PRC) was one of seven countries that participated in the RETA.

4. Country Case Studies and Workshops

The first part of the study examined the current accounting and auditing structure and systems adopted in the PRC. It also:

(i) analyzed the political, institutional, and regulatory and legal framework on accounting and auditing practice and the level of enforcement of existing laws, rules, and regulations; (ii) identified gaps and weaknesses in accounting and auditing support available and deviations from international standards; and (iii) identified alternative options to remedy the identified weaknesses, with the objective of eventually doing away with these.

The second part of this study disseminated the country-research findings through in-country workshops. Each workshop provided a cross-section of views on the research findings and established ways to move forward to improve financial management and governance in the country. After carrying out the assessment of accounting and auditing support in the PRC, the study findings and recommendations were discussed at a workshop in Beijing on 14 August 2000, and at an international conference at ADB Headquarters in Manila from 16-18
October 2000. This report incorporates feedback from the Workshop and the Conference.

5. The ADB Focus on Financial Governance in the PRC

ADB’s Country Operational Strategy for the PRC emphasizes three broad objectives: (i) improvements in economic efficiency, (ii) promotion of growth to reduce poverty in poor inland provinces, and (iii) environmental protection and natural resource management. ADB is supporting broad governance activities through the technical assistance program. Support for the drafting of the Public Procurement Law, its Standard Bidding Documents and Implementing Regulations; improved audit standards and procedures; strengthening the inspection function; support for the Bankruptcy Law and other key economic laws; and construction industry regulations and registration procedures are a few examples. More specifically, ADB is initiating policy dialogue to support the Government in the development of an efficient and commercially-oriented banking sector. To achieve this goal, the Government needs to: (i) establish a sound legal framework, (ii) enhance corporate governance and raise accounting and financial disclosure standards, (iii) improve banking regulatory and supervisory systems and liquidity management, (iv) improve legislation for bankruptcy and loan foreclosures, (v) develop efficient market infrastructures for payments, clearing, and settlements, (vi) deregulate interest rates, (vii) develop an effective strategy for debt resolution of State-owned Enterprises (SOEs), and (viii) ensure general public confidence in the banking system. This RETA directly contributes to these activities.

6. The People’s Republic of China

The PRC covers an area of 9.6 million square kilometers and is the world’s third-largest country, after Russia and Canada. Mountains dominate much of the country, but there are also large desert areas, high plateaus, and river basins. The PRC’s climate is subtropical in the south, arid in the northwest, and monsoonal in the east. The country is susceptible to floods, droughts, typhoons, and earthquakes.

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4 Ibid. p. 20.
After the end of the Second World War, the Communists fought a civil war against the Kuomintang. The Communists achieved victory in 1949 and, on 1 October of the same year, Mao Zedong proclaimed the People’s Republic of China (PRC) to an audience of 500,000 in Tiananmen Square. Beginning in late 1978, the Chinese leadership began to move the economy from a sluggish Soviet-style centrally-planned economy to a more market-oriented economy. To this end, the authorities switched to a system of household responsibility in agriculture in place of the old collectivization, increased the authority of local officials and plant managers in industry, permitted a wide variety of small-scale enterprise in services and light manufacturing, and opened the economy to increased foreign trade and investment.

In the past 50 years, the PRC has made tremendous progress in poverty reduction, particularly over the last two decades. Twenty years ago, the PRC was among the world’s poorest countries, with 80 percent of the population living on incomes of less than $1 a day and only a third of all adults able to read or write. Between the launching of the PRC’s economic reform program in 1978-1995, its transition from a command to a market-based economy helped fuel a remarkable average growth in Gross Domestic Product (GDP) of eight percent a year.

Since then, growth has remained relatively strong and incomes have generally continued to rise. Now, only about seven percent of the population between 15 and 25 years old is illiterate, and the PRC’s high life expectancy and low infant mortality rates are envied by much richer nations. The PRC has made great strides in improving social welfare. Consumption has more than doubled and the poverty rate has declined, as 200 million Chinese living in absolute poverty have been raised above the minimum poverty line. Prudent macroeconomic policy aided the PRC in adjusting to the Asian crisis. In 1999, growth slowed slightly and prospects are that a rate lower than the trend in the 1990s can be sustained in the medium term. The challenges will be to continue the reform process of opening the economy, improving efficiency in the state sector, addressing unemployment issues, and developing a legal and regulatory framework essential for efficient functioning of a market economy.5

There are about 1.26 billion people in the PRC, three-quarters of whom live in the countryside. The population is made up of some 56 ethnic groups who speak many different languages. The largest ethnic

group is the Han, who represent 92 percent of the population. By virtue of its huge population and geographic size, the PRC is one of the world’s major producers of grain, cotton, edible oil, meat, eggs, textiles, coal, steel, and cement. It is also a major producer of fertilizer, chemical fibers, hydroelectric power, and crude oil, and has enormous reserves of natural gas.
II. Accounting and Auditing in the PRC

This chapter presents an overview of accounting and auditing arrangements in the PRC. It provides context for the following chapters on professional infrastructure, accounting and auditing standards, accounting and auditing training, and government budgeting and accounting. The chapter comprises ten sections, in two parts, as follows:

Part One: Accounting
1. Introduction – describes the historical factors that have influenced accounting arrangements in the past 50 years.
2. Issues and Responses since 1979 – discusses the issues that faced the PRC in 1979 when the economic reform and open-door policy was initiated. It also summarizes the actions that were taken in response to these issues.
3. The ‘Chinese Accounting System’ – describes accounting arrangements. These include governing laws and regulations, accounting bases, asset management and internal-control systems, and accounting information systems.

Part Two: Auditing
5. Introduction – describes the development of auditing in the PRC.
6. Governing Laws and Regulations – describes the laws that govern PRC auditing practices and audit requirements.
7. Auditor Qualifications – describes auditor qualification requirements.
8. The Chinese National Audit Office (CNAO) – describes the role and functions of the CNAO, which is responsible for leading the auditing profession.
9. Chinese Institute of Internal Auditing (CIIA) – describes the internal auditing ‘profession’ and the functions and capacity of the CIIA.
10. Public Accounting and Auditing Firms – describes the presence of major domestic and international accounting firms in the PRC. The section also discusses four major initiatives to improve the quality of accounting and audit services within the PRC.
Part One. Accounting

1. Introduction

Central planning was introduced to the PRC after the end of the civil war in 1949. Before this, the PRC had public accounting firms and an accountancy profession. In the 1950s, the PRC adopted the Soviet accounting system that catered to the needs of central planning. The system provided statistical information, including financial information. It emphasized standardization and uniformity so that information could be compared across sectors and industries. Detailed instructions replaced professional judgment in the accounts-preparation process. Consequently, public accounting firms and the accountancy profession were disestablished.

The PRC’s 1979 decision to align accounting practices with the needs of a mixed-market economy posed a number of challenges. However, the Soviet accounting system created a sound basis on which to build. First, the system used many concepts of modern accounting including accrual measurement and double-entry bookkeeping. Second, large numbers of bookkeepers were trained in these concepts and became proficient in their application.

2. Issues and Responses since 1979

The PRC’s continuing accounting reforms have three objectives: (i) to standardize and rationalize financial reporting - this is expected to gradually improve the efficiency of business enterprises through associated improvements to financial management and control systems; (ii) to transit from the Soviet accounting model to the western accounting model - foreign investors encountered tremendous difficulties in understanding and preparing financial reports based on the Soviet model - the adoption of the western accounting model is expected to facilitate foreign direct investment in the PRC; and (iii) to gradually give business enterprises more discretion to design their own internal accounting and financial systems.

In the two decades since 1979, the PRC has made enormous strides in terms of developing an accounting infrastructure suitable to the needs of a market economy. The magnitude of these accomplishments is best viewed by examining the 1979 situation. First, bookkeepers numbered...

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in the tens of millions but there were no qualified Certified Public Accountants (CPAs) let alone a professional accounting body. Second, financial information on the performance and position of organizations was not publicly available. In any case, this information did not meet international standards nor did it cater to the needs of investors or lenders. Third, the users of financial information (investors and creditors) were unfamiliar with what they should demand from organizations. Fourth, financial information was not independently verified (audited) to international standards and could not be relied upon. Fifth, the entire legal framework was geared to central planning and specified exactly what information should be produced, how it should be produced, and to whom it should be provided. Finally, the regulatory entities that generally exist in market economies to oversee financial disclosure practices, such as securities exchange commissions, did not exist.

Table 1 summarizes developments in accounting arrangements in the PRC over the past two decades.

Table 1: The Development of the PRC's Accounting Infrastructure

<table>
<thead>
<tr>
<th>Year</th>
<th>Event</th>
</tr>
</thead>
<tbody>
<tr>
<td>1979</td>
<td>Economic reform and open-door policy initiated.</td>
</tr>
<tr>
<td>1981</td>
<td>First public accounting firm established in Shanghai. To promote the rapid development of the public accountancy profession, the Government allows organizations (including government ministries and businesses) to establish accounting firms as subsidiary units.</td>
</tr>
<tr>
<td>1988</td>
<td>Chinese Institute of Certified Public Accountants (CICPA) is established as a subsidiary unit of the Ministry of Finance (M OF). By the year 2000, CICPA will be one of the world's largest professional accounting bodies with around 135,000 members.</td>
</tr>
<tr>
<td>1992</td>
<td>MOF promulgates first accounting standard - the Basic Accounting Standard. It provides a conceptual accounting framework, sets out accounting principles, and is based upon International Accounting Standards (IAS).</td>
</tr>
</tbody>
</table>
MOF promulgates revised uniform accounting system regulations. The ‘uniform accounting systems’ prescribe charts of account, reporting formats and detailed accounting instructions. They replace the Soviet-based regulations and represent a fundamental update to accounting practices – largely in line with the Basic Accounting Standard and western accounting practice.

The MOF starts restructuring accounting firms with two objectives; to separate them from their parent organizations, and to encourage mergers. By the end of 1998, all accounting firms involved in the securities sector have been separated. By the end of 1999, the restructuring is largely complete.

1993 Certified Public Accountants (CPA) Law enacted. The Law provides legal backing to CICPA, lays down clear rules and regulations for CICPA’s administration system and organizational structure, and sets out CPA qualification procedures.

Accounting Law 1985 amended. The amendment broadens the Law’s scope from state-owned enterprises to all registered enterprises.

1995 CICPA promulgates first set of Independent Auditing Standards.

1997 CICPA joins the Confederation of Asian and Pacific Accountants (CAPA) and the International Federation of Accountants (IFAC).

A review of professional practices and ethics leads the MOF to start a clean-up (Rectification) campaign of CPA firms – by the end of the Rectification campaign in 1999, 12,700 individual CPAs and 580 CPA firms will have been forced from the profession.

1998 Chinese Accounting Standards Committee (CASC) formed. The CASC comprises seven members and provides advice to the MOF on accounting standards issues.

3. The 'Chinese Accounting System'

Governing Laws and Regulations

The recently amended Accounting Law 1985, the provisions of which came into force on 1 July 2000, governs the 'Chinese accounting system'. The original accounting law, which was promulgated in 1985, set out accounting arrangements, responsibilities and procedures for State-owned enterprises. The 1993 amendment widened the Law's scope to include all business and government organizations. The Accounting Law serves as the 'constitution' for the school of accounting regulations, and defines the accounting and reporting practices for all public and private sector organizations.

The 1999 amendment of the Accounting Law 1985 clarified the respective roles and responsibilities of the State, organization managers, and accountants for accounting procedures and accounting information. First, the revised law makes the person in charge of a corporation legally responsible for the truthfulness of accounting information. The more precise statement of responsibility is expected to strongly motivate enterprise leaders to work harder on internal management in pursuit of a good image. Second, accountants were previously responsible for monitoring financial operations on behalf of the State and organization owners. In addition to assigning responsibility to organization managers, the revised law personalizes the activities of accountants, who are now responsible for themselves rather than acting on behalf of the State. Finally, the revised law reinforced role clarity by introducing a range of financial penalties for contraventions.

Box 1: An Example of a New Statement of Responsibility

The Board of Directors of Anhui Gujing Distillery Company Limited hereby confirms that there are no important omissions, fictitious statements or serious misleading information in this report, and shall take all responsibility, individual and/or joint, for the reality, accuracy and completion of the whole contents.

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7 The amendment of the Accounting Law 1985 was adopted at the 12th meeting of the Standing Committee of the Ninth People's Congress on 31 October 1999 (Appendix 5 refers).

## Financial Management and Governance Issues in the PRC

The key laws and regulations that govern PRC accounting arrangements are as follows:

<table>
<thead>
<tr>
<th>Title</th>
<th>Description</th>
<th>Listed Cos.</th>
<th>Unlisted Cos.</th>
<th>Not-for-Profit Bodies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Companies Law 1993</td>
<td>Chapter 6 of this law requires companies to prepare annual financial statements that include a balance sheet, a cash flow statement and an income statement.</td>
<td>✓</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Securities Law 1998</td>
<td>This law took effect from 1 July 1999 and governs the issuance and trading of securities. The Law requires that organizations and individuals that prepare documents, such as audit reports for the issuance or listing of securities or for securities trading activities, must check and verify the truthfulness, accuracy and completeness of these reports and shall bear joint and several liability for the parts of such reports for which they are responsible.</td>
<td>✓</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

9  These include state-owned enterprises.
10 These include government units, schools, hospitals, etc.
In 1988, the MOF began work on establishing Accounting Standards. These were to be divided into a Basic Accounting Standard (that provided a framework), and specific standards (that provided guidance on specific issues – such as the treatment of contingent liabilities). The draft Basic Accounting Standard was prepared in November 1991 – it was formally promulgated at the end of 1992 and became effective from 1 July 1993. The Basic Accounting Standard provides the conceptual accounting framework, sets out accounting principles, and is based upon International Accounting Standards.

The Uniform Accounting Systems prescribe detailed sectoral accounting procedures and guidelines (e.g. for government units and for business enterprises). They provide charts of account, reporting formats, and detailed accounting instructions. This is where the requirements of the ‘Soviet accounting system’ were set out.
### Financial Management and Governance Issues in the PRC

<table>
<thead>
<tr>
<th>Title</th>
<th>Description</th>
<th>Listed Cos.</th>
<th>Unlisted Cos.</th>
<th>Not-for-Profit Bodies</th>
</tr>
</thead>
<tbody>
<tr>
<td>With the release of the Basic Accounting Standard, the MOF published a series of new uniform accounting systems for the major economic sectors. The new systems were broadly in line with western accounting and reporting practices. At the procedural level, they mirrored changes made in the Basic Accounting Standard.</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Specific Accounting Standards for Business Enterprises 1998 onwards</td>
<td>The MOF has promulgated ten Specific Accounting Standards since May 1997. They are based on International Accounting Standards (IAS) and provide specific accounting instructions on issues such as Cash Flow Statements and Construction Contracts. Further standards will be issued in the next few years.</td>
<td></td>
<td>✓</td>
<td>✓</td>
</tr>
</tbody>
</table>

### Accounting Bases

With the exception of government organizations, all organizations use double-entry bookkeeping and all transactions are recorded on the accrual basis. Not-for-profit organizations, such as health and education bodies, have recently moved to modified accrual accounting. Core government organizations use modified cash accounting. All organizations prepare balance sheets and record accrual (non-cash) adjustments – such as depreciation and provisions for bad debts. The basis on which these accrual adjustments are calculated however, varies between sectors and does not necessarily accord with international
practice. The Accounting Law 1985 requires all entities to disclose contingencies in financial and accounting reports.\(^\text{11}\)

Asset Management and Internal-Control Systems

The Accounting Law 1985 requires all organizations to maintain asset registers and to perform regular verifications of these assets. The uniform accounting system regulations prescribe procedures for bank reconciliations, bank account operations, asset verifications, and stocktaking. All organizations must establish accounting procedures and associated internal controls in line with the Accounting Law 1985 and associated regulations.\(^\text{12}\)

Accounting Information Systems

The accounting information systems of government organizations are described in chapter VI. The Government actively encourages computerization – therefore most accounting information systems are computerized. The Accounting Law 1985 requires that, where a computerized accounting information system is used, the system must be able to meet the requirements of the Accounting Law 1985 and associated regulations.

4. Financial Reporting Requirements

Introduction

Government financial reporting is described in chapter VI. Under the state-planned economic system, government agencies strictly controlled most business enterprises and financial reports were not disclosed to the public. With the development of the securities market, listed companies are now required to publicly disclose certain financial and non-financial information. In the past 15 years, various regulations on the public disclosure of information by listed companies have been prepared and promulgated. The increased demand for better information disclosure has closely followed the development of the securities market (Table 2 refers).

\(^\text{11}\) Article 19.
\(^\text{12}\) Article 27.
Table 2: Development of the PRC’s Securities Markets

<table>
<thead>
<tr>
<th>Year</th>
<th>Event / Regulation</th>
</tr>
</thead>
<tbody>
<tr>
<td>1979</td>
<td>Economic reform and open-door policy started.</td>
</tr>
<tr>
<td>1981</td>
<td>First public issue of treasury bills.</td>
</tr>
<tr>
<td>1984</td>
<td>First public issue of shares.</td>
</tr>
<tr>
<td>1986</td>
<td>Securities trading in the over-the-counter market allowed.</td>
</tr>
<tr>
<td>1990</td>
<td>Shanghai securities exchange established.</td>
</tr>
<tr>
<td>1991</td>
<td>Shenzhen securities exchange established.</td>
</tr>
<tr>
<td>1995</td>
<td>Law relating to the Punishment of Crime for Financial Disorder passed.</td>
</tr>
<tr>
<td>1998</td>
<td>Securities Law enacted to govern the issuance and trading of shares.</td>
</tr>
</tbody>
</table>

Reporting Requirements

The China Securities Regulatory Commission (CSRC) has published a series of regulations relating to the public disclosure of information by listed companies. For example: the Contents and Format of Prospectuses, and the Contents and Format of Annual Reports. On 8 December 1999, the CSRC promulgated Detailed Rules on Information Disclosures for Listed Companies under the Securities Law 1998. The regulation sets a number of requirements for annual reports. In particular, it requires listed companies to: disclose the full text of their annual reports on the Internet, present a summary in a designated newspaper, simplify the contents of annual reports, and provide more information about restructuring activities and on their parent companies.

As of July 2000, the CSRC was drafting improved guidelines on financial reporting (Interim guidelines on listed financial institutions' required information disclosures) which are likely to include the following: financial institutions must provide full information on asset quality, including the ways in which delinquent assets are managed; financial institutions must publish information on key business risks; and these financial institutions must be audited by approved CPA firms. In this respect, the CSRC is considering only allowing international CPA firms to conduct audits of financial institutions.

Benchmarks, Ratios, and Covenants

Shareholding companies are required to include a range of ratios in their financial reports (for instance, the current ratio, and the stock-turnover ratio). In 1999, the Central Government issued detailed rules, which required State-owned enterprises to report specified financial indicators (These include ratios such as Return on Equity and the Current Ratio).\(^\text{13}\)

Part Two. Auditing

5. Introduction

A rudimentary form of auditing emerged in China as early as the Western Zhou Dynasty – 3,000 years ago. A royal court was set up in the Song Dynasty in 992 AD. From then on, every dynasty established specific institutions or offices in charge of monitoring state finances. The PRC’s government-driven audit process is very different from the prevailing system found in western countries. The auditing profession comprises three major segments: government auditing, internal auditing, and social auditing (the equivalent of western public auditing).

6. Governing Laws and Regulations

In August 1994, the Audit Law was promulgated to strengthen state supervision through auditing, maintain the economic and financial order, promote the development of clean government, and ensure the healthy development of the national economy. The Audit Law 1994 defines the basic principles for government auditing supervision, government audit institutions and auditors, the responsibilities and powers of audit institutions, audit procedures, and the legal liability of auditors.

<table>
<thead>
<tr>
<th>Organization Type</th>
<th>Audit</th>
<th>Auditor</th>
<th>Requirements</th>
</tr>
</thead>
<tbody>
<tr>
<td>Securities and Futures Organizations</td>
<td>✓</td>
<td>Approved CPA Firms</td>
<td>Approved CPA firms must audit financial institutions. As of July 2000, the CSRC was drafting improved guidelines on financial reporting (Interim guidelines on listed financial institutions’ required information disclosures). In this respect, the CSRC is considering only allowing international CPA firms to conduct audits of financial institutions.</td>
</tr>
</tbody>
</table>
### 7. Auditor Qualifications

Auditors within CPA firms must be practising members of CICPA (i.e. CPAs) – CPA membership criteria are described in chapter III.

A further qualification – License of CPA and CPA Firms for Securities Related Practice – is required to audit securities-related businesses. In 1992, with the establishment and subsequent expansion of the Shanghai and Shenzen stock exchanges, only a few CPAs had qualified through the national uniform CPA examination. Most CPAs had received their certificates through subjective evaluation, which raised questions as to their technical competence. As a result, the MOF and the CSRC granted special licenses to those who sat and passed a special examination relating to accounting and auditing, and to the securities law. The special license enabled CPAs to audit securities businesses. Only around 100 CPA firms have this license and, in 1999, of the 4,988 candidates who sat for this qualification, only 467 (14 percent) passed. The examination is administered by the MOF and the CSRC and is organized by the National CPA Examination committee of the MOF. The MOF and the CSRC agree that the separate examination will be terminated in the near future when most CPAs will have qualified through the national uniform CPA examination.

### 8. The Chinese National Audit Office (CNAO)

**Introduction**

The PRC had no independent audit institutions from 1949 as internal supervisory bodies of the MOF controlled State finances. In December 1982, the National People's Congress (NPC) adopted a resolution to establish an auditing system in the PRC, which was included in the

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34 These include government units, schools, hospitals, etc.
amended Constitution. Because of this resolution, the CNAO was established in September 1983. Provincial, municipal and county governments then set up local audit institutions. The Auditor General heads the CNAO.

The CNAO audits public sector organizations (including many state-owned enterprises). It is also responsible for leading, developing and supervising the auditing profession. In reality, its private-sector supervisory activities are largely undertaken by CICPA (for instance, CICPA certifies auditors and audit firms, conducts practice reviews, promotes the development of the CPA profession, and coordinates and delivers professional training and education).

CNAO Legal and Regulatory Framework

The Audit Law 1994 stipulates that “the State Council shall establish an audit institution (the CNAO) that will audit the public revenues and expenditures of: departments of the State Council, departments of local governments, state banking institutions, and state enterprises.” The Constitution also stipulates that the Auditor General shall be a member of the State Council and that the Auditor General should be nominated by the Premier and, subject to the approval of the NPC or the NPC Standing Committee, shall be appointed or removed by the President.

According to the Constitution and the Audit Law 1994, the duties and responsibilities of the audit institutions are auditing: (i) the budget implementation, final accounts, management and use of off-budget departmental funds at the corresponding levels, and governments of lower levels; (ii) the assets, liabilities, profits and losses of State-owned monetary organizations and state-owned enterprises; (iii) the revenues and expenditures of state non-profit undertakings; (iv) the budget implementation and final accounts of state construction projects; (v) the revenues and expenditures of projects where assistance or loans have been provided by international organizations or foreign governments; (vi) state-owned enterprises that are vital to the national economy, receive large government subsidies or suffer substantial losses, as well as other state-owned enterprises designated by the State Council or corresponding local people's governments; and (vii) special funds such as social security funds and agricultural funds.
CNAO Organizational Structure

Public sector audit activities are uniformly managed - the audit institutions at each level report to the next higher level audit institution (Figure 1 refers). While the higher-level audit body directs the audit work of local institutions, local audit institutions report both to the higher-level body and to the local government.

Figure 1: Structure of the PRC’s Government Auditing System

Each year, audit institutions at various levels present reports on audit activities to the corresponding level of government. The Audit Institutions at each level also provide professional guidance and supervision to internal audit units, and conduct quality checks of public audit firms.

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The CNAO has 12 departments as follows:

- General office
- Foreign affairs department
- Personnel and education department
- Law department
- Public finance audit department
- Monetary audit department
- Non-profit government agencies audit department
- Trade and economic audit department
- Agriculture, resources, and environmental protection audit department
- Social security audit department
- Fixed assets investment audit department
- Foreign funds application audit department

The CNAO has branches based in Government departments and agencies (dispatched audit offices). In addition to conducting audit fieldwork, the personnel of these offices attend management and other meetings held by the audited bodies as formal participants or observers. The CNAO also has resident offices in the PRC’s 16 largest cities. Table 4 presents a breakdown of staff numbers as at June 1998.

Table 4: Staffing Levels of Nationwide Audit Institutions

<table>
<thead>
<tr>
<th>Type of institution</th>
<th>Actual</th>
<th>Allowed</th>
<th>Staffing Level (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>CNAO (including staff in dispatched offices)</td>
<td>1,934</td>
<td>3,360</td>
<td>58%</td>
</tr>
<tr>
<td>Provincial audit institutions</td>
<td>7,436</td>
<td>9,239</td>
<td>80%</td>
</tr>
<tr>
<td>Municipal audit institutions</td>
<td>23,619</td>
<td>26,114</td>
<td>90%</td>
</tr>
<tr>
<td>County audit institutions</td>
<td>53,624</td>
<td>51,398</td>
<td>104%</td>
</tr>
<tr>
<td>Total</td>
<td>86,613</td>
<td>90,111</td>
<td>96%</td>
</tr>
</tbody>
</table>

CNAO Staff Retention

In June 1998, only 58 percent of CNAO positions were filled (Table 4 refers). The staff-retention problem faced by CNAO is a common one for Supreme Audit Institutions. Two factors drive the problem. First, in view of its importance, the CNAO receives significant training assistance from multilateral and bilateral donors. This training,
combined with good on-the-job experience, makes its personnel attractive to the private sector and to other government organizations. Second, there is a significant gap between CNAO salaries and private-sector salaries. A CNAO director earns about $200 per month while their private counterparts earn upwards of $1,500 per month.

Independence, Financing, and Powers
The CNAO can freely access the financial records of all government organizations – with the exception of military bodies – and defines its annual audit program without external direction or interference. The CNAO’s budget is approved by the NPC on recommendation from the State Council. The military, as a separate part of the state apparatus, has its own audit function. Audit institutions have the power to: (i) require audited bodies to provide budgets, financial plans, statements about budget implementation, final accounts, financial reports, and other relevant information; (ii) review accounting information and assets of the audited bodies; (iii) investigate relevant issues and individuals about issues related to audit assignments and obtain evidence where necessary; (iv) suspend funding or freeze access to resources when auditees are in violation of state laws and regulations; and (v) report audit findings to relevant government departments and publish audit findings to the public.

Only very occasionally does the CNAO contract public accounting firms to conduct audits. Although the CNAO has contracting powers, it does not exercise these for two reasons. First, the CNAO has its own experts in specialist audit areas, such as financial institutions. Second, the CNAO’s limited financial resources restrict its ability to pay private sector fees. In the rare occasions that the CNAO does contract public accounting firms to conduct audits, these firms have to comply with the CNAO’s procedures and standards.

CNAO Auditor Qualifications
Many CNAO staff have CPA non-practising certificates. The CNAO has established an internal exam system for auditor qualifications.

International Relations
The CNAO has joined various international organizations, the main ones being the International Organization of Supreme Audit Institutions
FINANCIAL MANAGEMENT AND GOVERNANCE ISSUES IN THE PRC


Audit Certification and Reporting
Audit institutions have the power to report audit findings to relevant government departments and publish audit findings to the public. The CNAO also provides annual audit reports to the State Council, and then to the NPC. If approved, the reports are then available to the public. Audit opinions are issued at the conclusion of audits, as are management-letter type reports.

External Assistance to the CNAO
A number of countries and organizations have assisted the CNAO over the past decade. In many cases, this assistance has involved short-term training. Chapter VII provides details of the assistance – in summary:

- The Canadian International Development Agency (CIDA) provided training support in the late 1980s.
- ADB provided technical assistance from 1991 to 1995 that supported: the development of government auditing standards and audit procedures (including an audit manual), the design and implementation of a training program in relation to those standards, and the preparation of recommendations for office automation.\(^\text{17}\)
- The Australian Agency for International Development (AusAID) is currently providing extended in-Australia training for around 10 middle-ranking managers focusing on SOE auditing, and computerized audit approaches. It also is supporting the development of an audit-training manual for SOEs and the development of multimedia training materials.
- ADB is currently providing technical assistance to: reformulate the auditing standards, and design and implement an audit-training program to promote full and consistent adherence to the auditing standards.\(^\text{18}\)
- The German Technical Assistance Agency (GTZ) has provided equipment (information technology, office equipment, and training

\(^{17}\) TA No. 1483-PRC: Audit Administration of the PRC. $600,000. Approved 21 Feb 1991.
equipment), and is providing ongoing support to the CNAO, in particular, to the Continuing Education Centers.

- The World Bank is currently providing technical assistance to support: the establishment of a training program for auditors, the development of reference and training materials, and the development of management information systems.

9. Chinese Institute of Internal Auditing (CIIA)

The PRC has 92,500 Internal Audit units nationwide with around 243,000 professional staff. A recent survey of internal auditors found that their average experience was 9.1 years. This indicates that, in comparison to their more transient western counterparts, Chinese professionals tend to be career internal auditors. Over 90 percent of the survey respondents had college or higher-level training (survey respondents were from Chongqing, Guangzhou, Jinan, and Wuhan).

In most organizations, the size of the internal audit department is too small to operate as a fully functional strategic unit. This is compounded by the absence of audit committees, or their equivalent, in the Chinese environment. Moreover, the heavy emphasis on accounting matters lessens the emphasis in perceived value-added activities such as management or operational audits. As such, when the 50 percent organization-wide headcount reduction in all national agencies was mandated by the central government in 1998 (as part of the public-sector reform reforms), some internal auditing departments were eliminated.

The Chinese Institute of Internal Auditing (CIIA) is a government organization. Until recently, the CIIA did not have any members – it focused on research and training activities. These activities have included the translation of the International Certified Internal Auditor (CIA) exam into Chinese – around 1,000 candidates participated in the exams first offering in November 1998 in Guangzhou. In 1987, the CIIA joined the International Institute of Internal Auditors (IIA).

In 2000, the CIIA will be officially categorized as a professional member organization and will establish a membership base of internal auditors. It is expected that a significant portion of new members will come from private industries and joint ventures. The CIIA will also

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regulate professional activities, establish standards, and become more independent from the government. A new monthly professional journal will be launched with the inauguration of the new organization with an expected circulation of 80,000 per issue. The CIIA is also planning an aggressive national training program, including the establishment of specialized curricula at leading educational institutions.

10. Public Accounting and Auditing Firms

Introduction

After a 30-year hiatus, the first public accounting firm was established in the PRC in 1981. Much has happened in the ensuing 20 years – the PRC now has a thriving CPA profession. In the past two years, domestic accounting firm mergers have been actively encouraged – firms were previously legally allowed to only cover a single specific region.

The Big Five international accounting firms: Arthur Andersen, Deloitte Touche Tohmatsu, Ernst & Young, KPMG, and PriceWaterhouseCoopers are all established in the PRC. The Big Five firms employ 5,000 people in the PRC, over 90 percent of whom are Chinese nationals. They have seen a rapid increase in market share over the past several years. In 1992, their business turnover in the PRC was Y1.5 million ($186,000), which represented only 0.05 percent of the accounting profession’s total market volume. By 1997, turnover grew to Y510 million ($62 million), representing 17.5 percent of the total revenue of all accounting firms in the PRC. Such market growth is the main impetus behind the merger trend among the PRC’s domestic accounting firms.

The quality of accounting firms, their staff, and their activities has been mixed. The MOF and CICPA have taken, or are taking, the following steps to improve quality of accounting and audit services provided by public accounting firms:2021

• The Rectification Campaign (July 1997 – March 1999).
• Strengthening supervision (ongoing).
• Increasing competition and opening up the market (ongoing).

A Newspaper Article Shows the Extent of Auditing Weakness …

Random Audit Exposes Accounting Fraud in Most Chinese SOEs

Hua Sheng Bao. 12 December 1999. A random state audit of 100 state-owned enterprises (SOEs) in China found that 81 of the companies reported false assets worth ¥3.8 billion (US$459 million) and 89 SOEs reported false profits worth ¥2.7 billion (US$326 million).

The audits, which were under the direction of the Ministry of Finance, are part of a drive to improve China's dismal accounting practices, which prevent investors from assessing the value of listed firms, and make it nearly impossible for banks to tell whether a company is credit-worthy.

If the results of the sample audit are any indication of the accounting practices of the rest of China's 300,000 state-owned firms, then rosy official statistics for state sector profits may be way off the mark.

According to the State Economic and Trade Commission, the agency in charge of state-owned enterprises, SOE profits rose 93% on year to ¥48.2 billion (US$5.82 billion) in the first half of 1999.

Companies singled out as having particularly egregious accounting problems were the China Tourism Business and Trade Services, the China Daily newspaper, Liuzhou Bureau of Railroads, China Grains' Heilongjiang Import and Export Branch, Wuhan Tobacco Group and Wuhan Tobacco Sales.

To make matters worse, previous audits of the 100 SOEs by 82 public auditing firms had found nothing awry with the accounts of 62 of the firms, which seriously undermines government confidence in its public auditors.

As a result, the China Institute of Certified Public Accountants has issued a warning to a number of accounting firms, saying their SOE accounting services will be suspended for one year, that their illegal earnings will be confiscated, and that they will be fined.

Further highlighting the extent of China's accounting problems is a recent China National Audit Office (CNAO) probe of two of the nation's four big commercial banks, Industrial and Commercial Bank of China (ICBC) and the China Construction Bank (CCB), which found that the banks' assets, liabilities and shareholders' equity were over-reported by over ¥20 billion (US$2 billion), according to the December 17 Zhongguo Jingji Shibao (China Economic Times).

The Rectification Campaign (1997 – 1999)

From July 1997 to March 1999, a nationwide rectification campaign of the accounting market was conducted. The objective of the campaign was to standardize, and raise the quality of, accounting and auditing practices. The campaign had four stages:

I. Self-inspection. In the six months to December 1997, around 6,700 accounting firms conducted self-inspections. The self-inspections covered around 50 percent of their 1996–1997 activities. Just under 15 million business reports were inspected

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22 Overseas Chinese Newspaper.
- of these, 26 percent were considered to be either defective or in need of correction.

II. Focus Groups and Field Inspections. In January 1998, local CPA Institutes established working groups. In the following six months, these working groups conducted field inspections of 5,800 firms.

III. Inspection Reviews. From July to the end of October 1998, 192 people selected by CICPA reviewed the inspections conducted in stages I and II. The reviews focused on 405 accounting firms.


As a consequence of the campaign almost 12,700 individual CPAs were either forced to withdraw from the profession or were disciplined (25 percent of CPAs) – many of these were older members who had not passed the uniform accounting examination, and around 580 accounting firms withdrew from the profession or had their licenses cancelled – warnings and punishments were issued to a further 2,000 accounting firms (43 percent of firms).

CICPA judged the campaign to be a success based on the following evidence. First, during the period of the campaign, 6,300 newly qualified accountants joined the profession. The net effect was to substantially improve the profession’s age structure and knowledge. Second, to address problems that were identified in the inspections, 85 percent of accounting firms substantially improved their internal-management practices; improved professional rules; implemented or improved quality-control systems; increased training; and in doing so, effectively eliminated the problems that had been identified. Third, in 1998, the level of “non-clean” audit opinions given on listed companies rose dramatically (to around 12 percent of audit reports) which (arguably) indicated improved professional quality and ethics. Fourth, the credibility of CPAs in the eyes of the public, as measured by a media survey, climbed from 45 percent in 1996, to 81 percent in June 1998.

Structural Reform of CPA Firms (1992 – 2000)

When the CPA system was established in the early 1980s, most accounting firms were funded and managed by various government institutions, including the Ministry of Finance. In addition, corporate entities were entitled to start accounting firms. These arrangements supported the rapid establishment and development of the CPA profession but, with the deepening of the reforms, no longer met the needs of the market economy. First, the independence of accounting firms was greatly compromised, thus damaging their public image and social reputation. Second, the sponsoring corporate entities, not the accounting firms, bore the legal obligations, which blunted the positive incentive effects of litigation threats.

The general objectives of the structural reforms were to establish a management system for accounting firms that was commensurate with a mixed-market economy, and to directly expose accounting firms to legal obligations. Specific objectives were to develop accounting firms that were characterized by independent operation, self-assumption of risks, self-discipline and self-development, and to strengthen the risk awareness of CPAs, improve their professional ethics, and ensure quality. The reforms had two aspects:

- **Management system reforms.** These changes focused on deregulating personnel practices, service charges, salaries and benefits, businesses and financial management. They also focused on de-linking accounting firms from their corporate sponsors in four ways. First, organizational affiliation – accounting firms and their employees were no longer affiliated to the sponsoring entity. Second, financial affairs – the sponsoring entities lost their rights as equity owners. Third, business connections – accounting firms were forbidden to leverage the power and influence of the sponsoring entity. Fourth, names – auditing firms were forbidden to use their sponsoring entity’s names.

- **Organization structure reforms.** These changes focused on restructuring accounting firms into partnerships and limited liability firms (The CPA Law 1993 allowed two forms of accounting firms: partnership and limited liability. In line with the law, the
establishment of accounting firms as partnerships was strongly encouraged). Beginning in 1992, the MOF started restructuring the accounting firms. By the end of 1998, all firms qualifying as securities and futures businesses had been separated from their sponsoring entities and had been transformed into limited liability CPA firms. In April 1999, the MOF issued the Announcement on CPA Firms De-linking from their Sponsoring Organizations and the Structural Reform. This required all CPA firms to sever linkages with their sponsoring organizations and to adopt partnership or corporate (limited liability) structures within one year.

By the end of 1999, the structural reform of the accounting firms was pretty much complete – the number of firms had fallen from 6,045 to 4,805 and 1,240 firms had disappeared due to mergers and combinations. CICPA considers the de-linking and structural reforms a success because: (i) practitioners are now more aware of risk and responsibility; (ii) the profession’s age profile is younger and practitioners are more technically competent; (iii) the pace at which larger firms are developing has gained momentum; and (iv) the image of CPA firms has improved which has strengthened the confidence of domestic and foreign investors.

Strengthening Supervision (Planned)

Rectification campaigns can only be effective in the short term. In the long run, CICPA intends to lock in the success of the first two initiatives by improving supervision. Five main actions are planned: (i) strengthening the supervision and control of auditing in key fields (such as financial-institution audits), (ii) establishing a business reporting and recording system for accounting firms, (iii) improving CICPA’s monitoring and quality control capacity, (iv) formulating and improving supervisory regulations and introducing peer reviews, and (v) exposing professional failures in the media.

Increasing Competition and Market Opening (Ongoing)

CICPA recognizes that increased competition in the accounting services market will also improve professionalism and service quality. In

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particularly, CICPA believes that the entry of international firms to the domestic market will speed up the improvement of the PRC’s accounting profession and support the elevation of the PRC’s accounting firms to international standards.²⁶

The Big Five international accounting firms are all present in the accounting market which has been opened up through: (i) international accounting firms establishing permanent representative offices²⁷ in the PRC, (ii) the establishment of joint-venture accounting firms, (iii) the development of Chinese membership in international accounting firms, (iv) the issuance of temporary licenses to foreign firms, (v) the opening of the national CPA examination to non-Chinese citizens, and (vi) the promulgation of the 1998 regulation on Provisional Methods for Approval of Non-Chinese CPAs. The PRC’s accounting market is now more open than the markets of many other Asian countries. The PRC’s pending entry to the World Trade Organization (WTO) has influenced these initiatives, and the Government offered very generous terms for the opening up of the accounting market during WTO-entry negotiations.

CICPA intends to continue these initiatives. Its objectives are to: reinforce the establishment of joint-venture accounting firms; encourage the continuing establishment of respected international firms; encourage training and project cooperation between international and domestic firms; encourage communication between senior professionals from international and domestic firms; and establish the Foreign Experts’ Consulting Committee which will enable regular or irregular discussions and communications on a range of policy issues.


²⁷ By 1999, thirty-one such offices had been established - these offices had a 45 percent share of total industry revenues.
III. Professional Infrastructure

This chapter describes the professional accountancy infrastructure in the PRC, which comprises the Chinese Institute of Certified Public Accountants (CICPA) and its members. The chapter is structured as follows:

1. Introduction - reviews the development of the accountancy profession.
2. Legal and Regulatory Framework - describes the legal and regulatory framework that governs the operations and activities of the accountancy profession.
3. CICPA Structure and Financing - describes CICPA’s organizational structure.
4. CICPA Membership and Entry Criteria - discusses CICPA’s membership composition and entry criteria.
5. Continuing Professional Education (CPE) - describes professional training and continuing professional education arrangements.
6. Professional Ethics and Practice Supervision - discusses professional guidelines and practice supervision.
7. CPA Legal Liability - describes the complex issue of CPA legal liability.

1. Introduction

The PRC’s public accountancy profession was initially created in 1918. With the introduction of central planning and the uniform accounting system in the 1950s, the profession was disestablished. The economic reforms, which began in the late 1970s, again created the need for an accountancy profession. Consequently, the Chinese Institute of Certified Public Accountants (CICPA) was founded in 1988 and its activities are now governed by the Certified Public Accountants (CPA) Law 1993.\(^\text{28}\)

The profession has made tremendous progress during the past two decades. That progress is signified by many milestones including: the promulgation of the CPA Law in 1993, the Accounting Standards for Business

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\(^{28}\) In 1996 the new Chinese Institute of Certified Public Accountants (CICPA) was formed from the merger of CICPA and the Chinese Institute of Certified Auditors (CICA).
Enterprises (which came into effect in 1993), the issuance of the first batch of Independent Auditing Standards in 1995, and CICPA’s membership of CAPA and IFAC in 1997.

The Institute is one of the world’s largest professional accounting bodies - it currently has around 135,000 individual members and 4,800 group members (CPA firms). CICPA’s objectives are to: (i) promote the healthy development of the CPA profession; (ii) provide assistance in upgrading the quality of the profession; (iii) supervise the service quality and professional ethics of CPAs and CPA firms; (iv) coordinate relationships within and beyond the profession; (v) protect the legitimate rights and interests of CPAs, and (vi) serve the socialist market economy.\(^\text{29}\)

CICPA’s main duties and responsibilities are to: (i) manage the registration of CPAs and CPA firms; (ii) regulate the practices of CPAs and CPA firms; (iii) develop and monitor professional standards; (iv) organize and promote professional training; (v) organize the uniform CPA examination; (vi) conduct theoretical research and organize business discussions; (vii) promote domestic and international relationships; (viii) protect the rights and interests of members; and (ix) provide guidance to provincial CPA institutes.\(^\text{30}\)

Table 5 presents a chronology of the development of the PRC’s modern accountancy profession.

<table>
<thead>
<tr>
<th>Year</th>
<th>Event</th>
</tr>
</thead>
<tbody>
<tr>
<td>1980</td>
<td>As the PRC’s economic reforms commence, Professor Jiwan Yang advocates a return to the system of certified public accountants and the Ministry of Finance (MOF) agrees. Work begins under Professor Yang's supervision to set up accounting consulting offices in Shanghai and Beijing as test sites.</td>
</tr>
<tr>
<td>1981</td>
<td>First public accounting firm established in Shanghai.</td>
</tr>
<tr>
<td>1988</td>
<td>Chinese Institute of Certified Public Accountants (CICPA) established.</td>
</tr>
<tr>
<td>1991</td>
<td>Unified CPA examination introduced – it replaces subjective evaluation techniques that were used to screen potential CPA members.</td>
</tr>
</tbody>
</table>

\(^{29}\) CICPA Charter. 1996. Article 3.  

1993  Certified Public Accountants (CPA) Law enacted. The Law governs the accounting profession, sets out CPA qualification procedures, and provides legal backing to CICPA.

1995  CICPA limits issuance of CPA certificates only to those who have passed unified CPA examination. CICPA promulgates first set of Independent Auditing Standards.

1996  CICPA and Chinese Institute of Certified Auditors (CICA) merge.

1997  MOF and Chinese Securities Regulatory Commission (CSRC) issue regulations to restructure CPA firms. By the end of 1999, almost all CPA firms will have been separated from their sponsoring organizations.

A review of professional ethics leads the MOF to start a clean-up campaign of CPA firms – by the end of the “Rectification” campaign in 1999, 12,700 individual CPAs and 580 CPA firms will be forced from the profession. Most of the cases were due to violation of professional ethics, especially the submission of false audit reports.

CICPA joins CAPA and IFAC.

2. Legal and Regulatory Framework

The Institute conducts its operations in accordance with the CPA Law 1993, and the CICPA Charter. This section provides a broad overview of the Law and the Charter. Where relevant, the detailed requirements of the Law and the Charter are referred to elsewhere in this chapter and this report.

Law on Certified Public Accountants 1993

The CPA Law 1993 was developed to provide legal backing for the CICPA and for the PRC’s accountancy profession. The approval of the Law reflected the culmination of a great deal of research, analysis, and consultation. It came into effect on 1 January 1994. The Law lays down clear rules and regulations for the profession’s administration system.
and organizational structure. It sets out the following requirements and covers the following issues:

- Chapter I covers general issues (e.g., a CPA must be a member of an accounting firm in order to provide professional accounting services, (Article 3), and the MOF supervises and provides guidance to the accountancy profession (Article 5)).
- Chapter II sets out CPA examination and membership requirements and procedures (e.g., the MOF promulgates the regulations for the unified CPA examination – CICPA administers the examination (Article 8)).
- Chapter III defines the allowed scope of CPA activities.
- Chapter IV covers the procedures for establishing a CPA firm.
- Chapter V states that CPAs must be members of a CPA Institute. It also defines the structure of the Institute, and provides legal authority to the Charter.
- Chapter VI sets out legal responsibilities and disciplinary procedures.

CICPA Charter 1996
The Charter is issued under Article 34 of the CPA Law 1993 and specifies the objectives and functions of CICPA. It reiterates the requirement that the Institute must accept guidance from the MOF and the China National Audit Office (CNAO). The Charter also sets out: the Institute's membership structure, the Institute's management structure and procedures, and members’ rights and duties.

Other Regulations
A number of regulations that primarily relate to the activities of foreign accounting firms have been issued under the CPA Law 1993 (Table 6 provides details).

Table 6: Regulations

<table>
<thead>
<tr>
<th>Year</th>
<th>Regulation</th>
</tr>
</thead>
<tbody>
<tr>
<td>1996</td>
<td>Rules on Temporary Performance of Audit Services in the PRC by Hong Kong, Macao and Taiwan Accounting Firms.</td>
</tr>
<tr>
<td>1996</td>
<td>Provisional Regulations on Sino-Foreign Joint Venture Accounting Firms</td>
</tr>
<tr>
<td>1996</td>
<td>Provisional Regulations on Representative Offices of Foreign Accounting Firms</td>
</tr>
</tbody>
</table>
3. CICPA Structure and Financing

CICPA Structure

Figure 2 depicts the Institute’s structure. While the Institute is nominally an independent organization, it is under the direct supervision and direction of the MOF (major policies must be approved by the MOF). This section describes the roles and activities of the Institute’s key departments.

As its name suggests, the Comprehensive Department is responsible for a variety of activities. First, it coordinates the Institute’s internal activities. Second, it conducts research on the development of the profession and provides this research to the Institute’s leaders for consideration. Third, it prepares regulations and rules for the profession. Finally, it conducts publicity activities. The Registration
Department handles the registration of CPAs and CPA firms. It also reviews the recruitment and regulation of non-practising members. The Professional Standards Department prepares, and provides interpretations of, professional standards. In doing so, it researches and compares foreign professional standards, and domestic and foreign auditing theory and practices. The Practice Inspection Department contributes to improvements in professional ethics and professional service quality through the supervision and regulation of CPA practices.

The Training Department implements decisions made on training plans by the Leading Group for National Training of CPAs and its office. In addition, the Department prepares rules on training, provides advice on tertiary training, and sets up systems for Continuing Professional Education (CPE). The Examination Department implements decisions made on CPA examinations by the CPA Examination Committee. It also organizes the CPA qualification examinations and prepares examination rules and policies. These activities are supported by studies and research. The International Department manages the Institute's foreign relations (CICPA maintains close relations with over 70 foreign professional accounting bodies) and regulates the practising of foreign accountants in the PRC.

Internal Organization
In 1999, the structure of CICPA's new local area network (LAN) and wide area network (WAN) was studied and defined and implementation activities started. Systems analyses were also finished on: website design, office automation, exams management, and registration administration.

CICPA Financing
Over 84 percent of the Institute's revenue comes from group membership fees (Table 7 refers) - CPA firms are required to pay two percent of their revenue to the Institute.
4. CICPA Membership and Entry Criteria

Chapter II of the CPA Law 1993 sets out the CPA examination and registration requirements for individuals. The Ministry of Finance regulates the examination and CICPA administers and conducts the examination. The Institute has three membership categories:

- **Group members.** All approved accounting firms must become group members.
- **Individual members.** Individual memberships are broken into two categories:
  - Practising members, and
  - Nonpractising members.

Indians can join the Institute through two routes:
- Those who qualified through the former evaluation procedures (prior to 1995), or
- Those who have passed the uniform examination of all the required subjects and whose membership applications have been approved.

- **Honorary members.** The Institute’s Council has discretion to award honorary memberships to distinguished figures.

**Membership Criteria: Chinese Citizens**

The membership requirements for Chinese citizens are as follows:

(i) **Education** In addition to holding a university degree, must either:

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**Table 7: CICPA Revenues for the year ended 31 December 1999**

<table>
<thead>
<tr>
<th>Revenue Type</th>
<th>Y (10,000)</th>
<th>US$ (000s)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Group membership fees</td>
<td>6,714</td>
<td>8,109</td>
</tr>
<tr>
<td>Individual membership fees</td>
<td>64</td>
<td>77</td>
</tr>
<tr>
<td>Examination fees</td>
<td>1,200</td>
<td>1,449</td>
</tr>
<tr>
<td>Other income (primarily from the provision of services, although a small government endowment is included).</td>
<td>70</td>
<td>85</td>
</tr>
</tbody>
</table>

Total: 8,048 9,721

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have completed a two-year college program at a recognized institution.

( ii ) Examination

Must sit and pass the uniform examination in all required subjects:

- Accounting
- Auditing
- Taxation
- Economic Laws, and
- Financial and Cost Management.

Applicants must pass all examinations within five years. Exam exemptions can be given to those who hold high-ranking technical titles in relevant subjects.

( iii ) Experience

Must have had at least two years’ working experience as an auditor.

Membership Criteria: Foreign Citizens

In order to become a practising member of CICPA, foreigners must: have been a non-practising member for at least one year; be working in an accounting firm in the PRC; have at least two years’ working experience as an auditor in the PRC; and have a permanent address in the PRC, and by the time of their application, must have been in the PRC for at least one year cumulatively.

Group Members (Accounting Firms)

Approved accounting firms must become group members of the Institute. Article 23 of the CPA Law 1993, sets out the establishment criteria for an accounting firm:

- Two or more CPAs in partnership can establish an accounting firm – partners are jointly liable for the firm’s liabilities (Article 23).

- An accounting firm can enjoy limited liability protection if:
  - its registered capital is at least Y300,000, and
  - it has at least five full-time professional staff who are CPA members (Article 24).
Membership Composition

<table>
<thead>
<tr>
<th>Category</th>
<th>Members as at 31 Dec 1999</th>
</tr>
</thead>
<tbody>
<tr>
<td>Group members</td>
<td>4,805</td>
</tr>
<tr>
<td>Individual members:</td>
<td></td>
</tr>
<tr>
<td>o practising members</td>
<td>60,391</td>
</tr>
<tr>
<td>o non-practising members</td>
<td>75,261</td>
</tr>
<tr>
<td>Honorary members</td>
<td>8</td>
</tr>
</tbody>
</table>

By the end of 1999, members included: seven Chinese-foreign joint-venture CPA firms; 11 member firms of international accounting firms; 27 representative offices of international accounting firms; and 267 overseas individual members (of whom 11 had become Chinese CPAs). The Institute predicts that by 2010 it will have 200,000 individual members.

The Uniform CPA Examination

Before 1991, CPAs were certified through evaluation. The evaluation criteria emphasized work experience and varied greatly between regions. Furthermore, the reviewing officials (usually from the local government finance bureaus or branches) were not familiar with the accounting profession or the requirements for a qualified accountant. The quality of CPAs who qualified under this system varied greatly. Moreover, many retired government officials used their old connections to join the profession.\(^{33}\)

In 1991, CICPA adopted the prevailing international practice of requiring members to pass a uniform examination. The Ministry of Finance regulates the examination and CICPA administers and conducts the examination. A record 458,000 candidates sat the examination in 1999 making it one of the world’s largest practising-certificate examinations. The exam was held in 308 centers in 31 provinces. Around 50,000 candidates have passed the examination since 1991. Table 8 provides pass-rate information for each subject.


Table 8: CPA Examination Candidates and Pass Rates (1999)\(^{34}\)

<table>
<thead>
<tr>
<th>Subject</th>
<th>Successful Candidates</th>
<th>Pass Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounting</td>
<td>22,534</td>
<td>14.4%</td>
</tr>
<tr>
<td>Auditing</td>
<td>10,814</td>
<td>15.3%</td>
</tr>
<tr>
<td>Financial management and cost accounting</td>
<td>14,767</td>
<td>15.3%</td>
</tr>
<tr>
<td>Economic laws</td>
<td>20,594</td>
<td>16.8%</td>
</tr>
<tr>
<td>Tax laws</td>
<td>32,388</td>
<td>25.7%</td>
</tr>
</tbody>
</table>

5. Continuing Professional Education (CPE)

This section focuses on continuing professional education (CPE) for CPAs. The General Standard on Continuing Professional Education was issued in accordance with the CPA Law 1993 and came into effect on 1 January 1997. It defines what constitutes CPE responsibilities for organizing and implementing CPE. The Standard also sets out inspection criteria (for instance, Article 18 states that “if the CPA cannot provide the proper records of CPE, or has no reasonable excuse for not meeting the CPE requirements, he cannot pass the evaluation.”).

Practising members are required to complete 180 hours of CPE every three years, with a minimum of 40 hours per year. They are required to participate in CPE under the multilevel system that has recently been established. Under the multilevel system, CICPA organized-training takes the lead, training organized by local CPA firms supports the CICPA initiatives, and self-training provides the foundations. In 1999, 45,000 trainees attended 282 CICPA training courses and ten new sets of CPE materials were prepared and published. There are no specified requirements for non-practising members although these are being developed.

CPE materials are also prepared under specific projects. For instance, training manuals and videocassettes are being developed to explain the new accounting standards that are being prepared under the World Bank-supported Accounting Reform Project. The CPE system has been continuously improved over the past decade. The Institute established the Committee for Preparation and Review of Teaching Materials for the CPE of CPAs in 1999. The Committee’s objective is to improve the quality and effectiveness of continuing education.

professional education (CPE). In doing so, it is preparing materials covering existing issues and new issues – the practical case-study teaching method is preferred.

In future, attention will be paid to ethical and code-of-conduct issues – particularly for those who become partners in de-linked firms.

6. Professional Ethics and Practice Supervision

The General Standard on Professional Ethics was issued in accordance with the CPA Law 1993 and came into effect on 1 January 1997. It reflects international practices and describes professional competence, client responsibilities, CPA responsibilities, and general responsibilities (for instance, what constitutes unacceptable business-solicitation practices).

The General Standard on Quality Control was issued in accordance with the CPA Law 1993 and came into effect on 1 January 1997. Article 37 of the CPA Law 1993 requires CICPA to conduct annual examinations of professional qualifications and annual inspections of CPA practices. The main requirements for the supervision of the public accountancy profession are as follows:

- CICPA works together with the General Office of Specially Appointed Inspectors, the CSRC, CNAO, and finance supervision agencies, to verify the practice quality of CPA firms.
- CICPA shall strengthen self-regulation and establish an investigation committee and a disciplinary committee in order to raise the effectiveness of self-regulation.

Annual practice inspections are conducted with the objective of strengthening practice regulation, standardizing professional conduct, and improving service quality. In 1999, CICPA paid particular attention to those CPA firms with licenses to conduct audits of security-related businesses. Moreover, new policies were introduced to help practitioners to meet the requirements of the new environment, and to reduce risks. The MOF is authorized to impose penalties on members for deviations from professional standards. These penalties include warnings, the confiscation of illegal earnings, the imposition of fines, the suspension of practice licenses, and the withdrawal of practice licenses.
7. **CPA Legal Liability**

The legal liability of CPAs has become a major issue in the past five years. On one hand, the threat of legal action is improving professional ethics and audit quality. On the other hand, conflicting laws and over-generous rulings are undermining the attractiveness of auditing. The legal liabilities of Chinese CPAs include:

(i) **Administrative liabilities.** These refer to disciplinary actions imposed by the Government or CICPA. As per Article 39 of the CPA Law 1993, disciplinary sanctions include warnings, practice suspensions, and withdrawal of CPA certificates. In 1996, CICPA issued the Penalty Rule of CPAs. In January 1998, the MOF promulgated the Provisional Regulation on Penalties for Breach of the CPA Law. Both pronouncements provide detailed explanations of the regulations and associated penalties for violations.

(ii) **Civil liabilities.** These result from breach of contract and negligence. In addition to the General Rules of Civil Law, Articles 39 and 42 of the CPA Law 1993, stipulate that CPAs are obliged to refrain from infringing on the economic interest of the client, or other related parties, and are liable to compensate for any financial loss.

(iii) **Criminal liabilities.** The criminal liabilities of CPAs were first stipulated in Article 6 of the National People's Congress' Decision for Breach of the Company Law, which took effect in February 1995. According to Article 6, auditors can be sentenced to a maximum of five years' imprisonment, and fines of up to Y200,000, if they provide false verification reports resulting in material damages. The Criminal Law 1997 also stipulates CPA criminal liabilities for negligence.

The period 1981-1991 has been characterized as the "fermentation period" (with regard to CPA legal liabilities).³⁶ During this time, the accountancy profession was in its infancy, there were practically no legal disputes over legal quality, and the Ministry of Finance issued no punishments for negligence. This was primarily due to the profession's small size, lack of influence, and presence of government oversight and

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professional infrastructure. At the same time, audit quality was poor and professional ethics were weak.

The period 1992-1995 has been characterized as the “embryonic period.” While the explosion of enterprises, all requiring capital verification and auditing work, was good for the CPA profession, these enterprises and their financiers began to expect higher-quality financial information. This marked the beginning of people’s awareness of CPA legal liabilities. At the same time, CICPA and related government departments reviewed the liability situation and issued the following regulations and standards:

- the Provisional Regulations on the Management of the Issuing and Interaction of Stocks (April 1993) specified the liabilities to be accepted by CPAs in the stock market
- the Accounting Standards for Business Enterprises came into effect on 1 July 1993 and provided criteria against which to judge whether accounting statements were just and fair
- the Provisional Regulations on Prohibiting Fraudulent Behavior Involving Securities (issued by the Securities Commission of the State Council in August 1993) specified the legal liabilities that CPAs must accept for providing false or misleading reports concerning the stock market
- the Corporation Law 1993 established the auditing system for annual corporate reports and specified CPA legal liabilities for negligence and fraudulent conduct, and
- the CPA Law 1993 stipulated CPA legal liabilities for fraudulent conduct.

At the same time, the profession’s supervisory bodies imposed heavy penalties against CPAs involved in three auditing cases. Together, these regulations and disciplinary actions raised public expectations of CPAs. They resorted to litigation when their expectations were not met.

The period from 1995 onwards has been called the “indepth development period.” It began with the issuance of:

- the Independent Auditing Standards (1 January 1996) which stipulated standards for CPA conduct, and
- the Legal Correspondence No. 56 of the Supreme People’s Court which clarified CPAs’ legal liabilities. On 4 April 1996, the Supreme People’s Court issued a legal letter regarding the issuance of a false capital verification report by the Sichuan Deyang CPA firm. The
letter stated that the firm should be held legally liable and be required to compensate. An explosion of lawsuits, regarding capital verification, resulted. In 1997, many cases were ongoing. By 1999, one survey contended that about one-third of all CPA firms had been involved in lawsuits. However, the accuracy of this estimate has been strongly questioned. The body of laws regarding CPAs' legal liabilities is self-contradictory in two primary ways, as discussed in the following paragraphs.

First, there is a contradiction caused by block (or targeted) legislation - the same conduct can result in different penalties under different laws. For example:

- **Article 161 of the Securities Law 1998:**
  ...professional organizations and personnel who provide documents such as audit reports, capital-verification reports, or legal opinions for the issuing, listing, or exchanging of securities must submit their reports in accordance with the procedures required by professional regulations, verify and reexamine their truthfulness, accuracy, and completeness, and accept joint liability for what they are held responsible for.

- **Article 39(3) of the CPA Law 1993:**
  It is necessary to investigate the criminal liabilities of accounting and CPA firms proven guilty of violating Article 20 and Article 21 of this law and deliberately submitting false audit reports or capital-verification reports.

- **Article 229 of the Criminal Law:**
  Those intermediaries who are engaged in the valuation of assets, capital verification, accounting, auditing and legal services but who commit serious errors of deliberately providing false verifying documents should be sentenced to imprisonment ...for up to five years, and should be fined in accordance with the law...

- **Article 219(1) of the Corporation Law:**
  It is necessary to confiscate the illegal income gained by asset valuation or capital verification offices by providing false documents, and to impose a fine of two to five times of that illegal income. ...

The Securities Law 1998 and the CPA Law 1993 emphasize CPA work procedures so, if a procedure is legal, even if the auditing result does not agree with the facts, CPAs are not legally liable under these laws. These

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37 The Supreme Court followed up Legal Correspondence No. 56 with successive interpretations on CPAs' civil liabilities – Legal Reply No 3 (1996), Legal Interpretation No.10 (1997) and Legal Interpretation No.13 (1998).


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two laws make a distinction between negligence in work and unavoidable objective factors; CPAs are only required to accept joint liability for the former. In contrast, the Criminal Law and the Corporation Law emphasize the results of CPAs’ work and the liabilities they should accept for submitting false audit reports.

Because of audit limitations, CPAs are never able to discover all frauds. Hence, most countries keep CPA liabilities within the domain of professional standards. However, the formulation of law in the PRC follows the block pattern, so contradictions will occur. Most of the disagreements between the law courts and CPAs are related to this phenomenon.

Second, there is a problem relating to the extent to which CPA firms should provide compensation. The four Supreme Court documents (see above) cause two major legal problems in relation to CPA compensation.

- There are contradictions between the four interpretations:
  - Legal Correspondence No. 56 (1996) and Legal Interpretation No. 13 (1998) stipulate how much CPAs should pay in compensation.
  - Legal Reply No 3 (1996) and Legal Interpretation No. 10 (1997) say that CPAs should pay compensation with the scope of the untruthful part of their capital verification report or within the verified amount of false capital.\(^{39}\)

- The four legal documents focus on capital verification but fail to stipulate compensation for other auditing activities.

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\(^{39}\) In one case, a company had net capital of Y2.6 million, but the CPA submitted a capital-verification report of Y3.5 million – so the untruthful part was Y0.9 million. In its decision, the Court referred to Legal Interpretation No. 13 (1998), and required the CPA firm to pay Y3.5 million. This ruling also agreed with Legal Correspondence No. 56 (1996), but disagreed with Legal Reply No 3 (1996) and Legal Interpretation No. 10 (1997). Reference: Li, Ruoshan, and Hong He. 2000. An Analysis of the Development and Current Situation of the Civil Legal Liabilities of CPAs in China. China Accounting and Finance Review. Vol. 2(1). March 2000. pp. 104-120.
IV. Accounting and Auditing Standards

This chapter describes the accounting and auditing standards that govern the preparation of external financial reports and the audit of those reports. The chapter comprises five sections, in two parts, as follows:

Part One: Accounting Standards
1. Introduction
3. Accounting Standards – discusses the development of accounting standards, describes the bodies that are involved in their development, and compares the standards against International Accounting Standards (IAS).

Part Two: Auditing Standards
4. Independent Auditing Standards
5. Government Audit Standards

Part One. Accounting Standards

1. Introduction

In the 1950s, the PRC adopted a highly centralized administrative system from the Soviet Union. Under the system (called the Financial System for Business Enterprises – also called the “old uniform accounting system”), the financial management of enterprises was strictly controlled by the central Government. Headed by the Ministry of Finance, the task was carried out by finance bureaus in various levels of local government.

The Financial System for Business Enterprises had three characteristics. First, there was specific and strict government control over financial matters relating to sourcing, production, and marketing activities. Second, there was a vague distinction between taxes and profits since the Government was the sole owner of enterprises. Third, accounting was regarded as an integral part of the control system and directions that are usually included in the accounting standards of other countries were incorporated into the financial system.
Different financial systems were designed for different ownership arrangements and for different economic sectors. These systems created the following problems:

(i) Different profit-allocation and taxation mechanisms created unfair competition among enterprises. For instance, large and medium-sized State enterprises were subject to a profits tax rate of 55 percent, collective and township enterprises were subject to an eight-scale profits tax rate, and foreign enterprises enjoyed tax exemptions and a tax rate of 33 percent. This system adversely affected production incentives and focused attention on beating the rules, not on improving efficiency.

(ii) They inhibited enterprises' operating mechanisms. One financial statement was divided into three self-balancing funds: fixed assets, current assets, and special assets. Funds were nontransferable which reduced enterprise flexibility. For instance, it locked enterprises into a particular structure and production function.

(iii) They inhibited enterprise integrations. Under the centrally-planned economy, each enterprise was normally engaged in a single line of business. The economic reforms encouraged product-line diversification, and vertical and horizontal integrations. When these changes took place, the parent enterprise's specific financial system was required to be used by all acquired enterprises. It was unreasonable for a large group, engaged in various areas of business, including manufacturing, distribution, and financial servicing to follow only one specific financial system.

In the early 1990s, the PRC developed overall objectives for accounting-system reform. These objectives included the development of a series of basic and specific accounting standards that would be consistent with international accounting practices and that would cater to Chinese realities. A two-phase strategy was developed to achieve these objectives. First, the planned-economy accounting system would be transformed into a market-economy accounting system. The promulgation of the Basic Accounting Standard in 1992 was a key output of this phase. In addition, a new set of uniform accounting systems was published for the major economic sectors. Second, a full system of accounting standards for enterprises would be developed over
The new standards will apply to all Chinese enterprises and will bring the Chinese accounting system into line with international practice. Among the accounting characteristics specified in the standards are: the use of double-entry accounting (which was also used in the old system), accrual based accounting (which has always been used), and principles such as consistency and conservatism.

In 1992, the Ministry of Finance issued the first of the PRC’s new IAS-based accounting standards – Accounting Standards for Business Enterprises No. 1 – Fundamental Accounting Standards. A further ten standards have been issued since and more are on the drawing board. With the release of the first new accounting standard, the Ministry of Finance published a series of new uniform accounting systems for the major economic sectors (e.g. Government Agencies, Public Institutions and Business Enterprises). Figure 3 illustrates these changes.

Figure 3: The Old and the New Accounting Systems

The Ministry of Finance (MOF) is responsible for developing accounting standards. To exercise that function, the MOF has set up the Accounting Regulatory Department. In addition, and in line with the CPA Law 1993, the MOF supervises and guides the CPA profession, and approves all accounting standards. In October 1998, the China

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41 Article 6 of the Accounting Law 1985.
Accounting Standards Committee (CASC) was established to provide advice on the setting of accounting standards.

2. New Uniform Accounting Systems (Financial Standard)

The new uniform accounting system (1992) standardized the financial activities of all business enterprises, public enterprises, and government agencies and addressed many of the issues associated with the old system. The key reform areas were as follows:

(i) It introduced the concept of owners' capital and upheld capital maintenance. For instance: profits and losses on fixed asset sales are no longer regarded as capital transactions; and special funds have been eliminated.

(ii) The reformed treatment of depreciation has helped technology improvements. The new Financial Standard allowed enterprises to choose their own depreciation policies. The subsequent adoption of accelerated-depreciation rates had favorable effects on technology improvements.

(iii) Reform of cost management systems. Most countries use the manufacturing costs method (which divides costs into manufacturing costs and period costs). Along with other changes, the new Financial Standard mandated the use of this method.

Box 2: Features of the New Uniform Accounting Systems

The New Uniform Accounting Systems provide detailed accounting regulations for each sector. These regulations prescribe technical guidelines including: definitions of accounting terms, detailed descriptions of the items to be included in each account, rules for journal entries, a uniform chart of accounts, and rules of measurement and verification. Accounting practices must comply with these guidelines.

The old systems were criticized as extremely complicated and unnecessarily detailed. Moreover, they did not satisfy the information needs of investors, lenders, and other users. The implementation of the new financial reporting systems and the establishment of the new financial performance measurement system was seen as having two benefits. First, the old financial statements comprised of: the three-part

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self-balancing statement of financial position, the income statement, the cost statement, and other statistical reports. The new financial standard altered these to: the balance sheet, the income statement, the statement of changes in financial position⁴³, and related notes. These changes were intended to highlight an enterprise’s assets, liabilities, and owner’s equity, and to satisfy the needs of the various users of the financial statements. Second, there was previously no way of consistently evaluating the performance of an enterprise. The new Financial Statement adopted western methods of financial analysis (for instance, the current ratio, and the stock-turnover ratio).

3. Accounting Standards

Introduction
This section describes the PRC’s new accounting standards. It begins by reviewing the history of their development then describes the operations and activities of the standard-setting bodies. A status update on accounting is provided and the section concludes with a discussion of differences between the accounting standards and International Accounting Standards (IAS).

A Recent History of Accounting Standard Setting
Since 1949, when the PRC adopted central planning, the Government strictly controlled all economic entities, including business enterprises. To meet the information needs of central planning, accounting practices were required to adhere to a uniform accounting system that was designed by the Accounting Regulatory Department of the MOF.

The appropriateness of the uniform accounting system was reconsidered with the introduction of the economic-reform program at the end of the 1970s. The systemization of accounting concepts, principles, and standards was considered an important issue. With the development of the market economy, the uniform accounting system was considered inadequate to cope with the complexity of accounting affairs in the PRC.

⁴³ Cash Flow Statements replaced this in 1998.
Box 3: Key Differences between the Uniform Accounting System and International Accounting

The traditional Chinese accounting systems differed from western accounting conventions in the following key areas:

- They presented a high company net worth since provisions for future events were not included (e.g. provision for doubtful debts).
- The determination of asset values was difficult since land was not usually privately held, nor did secondary markets exist.
- Reporting formats were substantially different.

In its 1988 Program on Accounting Reform, the MOF stated that the Accounting Regulatory Department should abandon the traditional approach of monitoring accounting affairs, and that accounting standards should replace the existing uniform accounting system. In March 1988, the Panel on Accounting Standards (that was set up by the MOF and tasked with designing a blueprint for the accounting reforms) issued two documents: the Tentative Plan for the Establishment of Accounting Standards in the PRC, and a Discussion Memorandum on Major Issues Related to the Establishment of Accounting Standards in the PRC. The Plan recommended that a research group under the MOF should draft formal accounting standards. It also recommended that the Statement of Accounting Standards should be effective for financial reporting for the 1990 fiscal year.

In April 1989, the MOF circulated An Outline of Accounting System Reform in the Near Future. The outline specified four guidelines for this task including the need to maintain consistent with national economic policies, to take account of the PRC’s socio-economic environment, and to harmonize the relationship between accounting standards and financial regulations. The Outline divided accounting standards into two levels: basic standards (conceptual framework), and specific standards (detailed rules and procedures).

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Box 4: Factors Influencing the Adoption of Accounting Standards

The five critical factors that are credited with the move to accounting standards are as follows:

1. The Government’s changing role in macro-economic management. The Government’s role is changing from direct control of business enterprises, through central planning, to indirect control using fiscal and monetary policies. Central planning required uniform information.

2. The increasing complexity of business transactions. The uniform accounting system was not based upon a set of basic accounting theories (conceptual framework) and could not keep pace with the introduction of many new forms of business transactions. In equipment leasing, for example, accountants found it difficult to handle these transactions in the accounts.

3. The diversification of business ownership and operation. Under the old system, different government bodies divided by industry sector monitored business operations. With the diversification of ownership and operations, this was no longer possible or necessary.

4. The open-door economic policy led to an influx of foreign investment and the presence of foreign businesses. These businesses needed to comply with Chinese accounting regulations and accounting and financial reporting standards in their parent company.

5. The expansion of the securities market was probably the most influential factor in that it encouraged the adoption of internationally accepted accounting principles and standards.

In November 1991, the MOF issued a formal Exposure Draft on accounting standards called the Accounting Standards for Business Enterprises No. 1: The Basic Accounting Standard. The Standard was formally promulgated at the end of 1992 and it became effective from 1 July 1993.

Standard-Setting Bodies and Processes

As described in the chapter introduction, the China Accounting Standards Committee (CASC) was established in October 1998 to provide advice to the MOF on accounting-standard setting. It has seven members including experienced public sector experts, academic experts and accounting professionals. The CASC has similar objectives to accounting standards-setting bodies operating in other countries. The accounting-standard-setting framework adopted closely parallels the

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Japanese approach (the Japan Accounting Standards Deliberation Board is part of the government). This arrangement contrasts with arrangements in some other countries where accounting standards bodies are semi-professional associations.

Figure 4: The Relationship between the MOF and the CASC

Accounting standards are developed through a consultative process. The World Bank is supporting this process through the Accounting Reform and Development Project. A series of accounting standards have been identified for development (see below). Process timing varies according to the nature of each standard. The broad process steps are as follows:

- **Research and Drafting:** The CASC Secretariat is employing a consultative group of domestic and international consultants (Deloitte Touche Tohmatsu) to undertake research into particular issues associated with each standard.

- **Exposure:** The Accounting Regulatory Department releases Exposure Drafts (EDs) of each standard for general public comment. Each ED is published in the Government newspaper – the exposure period is usually two months. Six seminars will expose the draft accounting standards to experts before their publication (from 1999 to 2001).

- **Promulgation and Dissemination:** Four seminars will be held in key locations for about 350 high-level participants who are senior provincial accounting and finance policy makers (from 1999 to 2001). The seminars will cover the dissemination of, and training in, the new standards. In addition, master training manuals and videocassettes will be prepared for each standard. These materials will be published and distributed by publishing houses.  

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Status of Accounting Standards

The system of China Accounting Standards consists of a general standard titled The Basic Accounting Standard, and a series of specific standards. The basic standard, which was implemented in 1993, prescribes accounting assumptions and the general accounting principles, the accounting elements, and the general requirements for the preparation and presentation of financial statements. Specific standards are prepared in accordance with the basic standard. Since 1993, the Ministry of Finance has focused on the development of the specific standards.

The standards that have been issued so far provide a framework for basic accounting in shareholding companies. Different accounting policies are set out in the accounting system to cater to the differences between domestic and overseas listed companies. As at 30 June 2000, the following accounting standards had been developed and promulgated:

<table>
<thead>
<tr>
<th>Accounting Standard (IAS Equivalent)</th>
<th>Applicability</th>
<th>Promulgated</th>
<th>Effective</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Basic Standard</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>The Basic Standard (IAS Framework)</td>
<td>All</td>
<td>November 1992</td>
<td>1 July 1993</td>
</tr>
<tr>
<td><strong>Specific Standards</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Disclosure of Related Party</td>
<td>Listed</td>
<td>May 1997</td>
<td>1 January 1997</td>
</tr>
<tr>
<td>Relationships and Transactions (IAS 24)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash Flow Statements (IAS 7)</td>
<td>All</td>
<td>March 1998</td>
<td>1 January 1998</td>
</tr>
<tr>
<td>Events Occurring After Balance Sheet Date (IAS 10)</td>
<td>Listed</td>
<td>May 1998</td>
<td>1 January 1998</td>
</tr>
<tr>
<td>Debt Restructuring (No Direct IAS Equivalent)</td>
<td>All</td>
<td>June 1998</td>
<td>1 January 1999</td>
</tr>
<tr>
<td>Revenues (IAS 18)</td>
<td>Listed</td>
<td>June 1998</td>
<td>1 January 1999</td>
</tr>
<tr>
<td>Accounting Standard (IAS Equivalent)</td>
<td>Applicability</td>
<td>Promulgated</td>
<td>Effective</td>
</tr>
<tr>
<td>-------------------------------------</td>
<td>---------------</td>
<td>-------------</td>
<td>----------------</td>
</tr>
<tr>
<td>Construction Contracts (IAS 11)</td>
<td>Listed</td>
<td>June 1998</td>
<td>1 January 1999</td>
</tr>
<tr>
<td>Non-monetary Transactions (No Direct IAS Equivalent)</td>
<td>All</td>
<td>June 1999</td>
<td>1 January 2000</td>
</tr>
<tr>
<td>Contingencies (IAS 37)</td>
<td>All</td>
<td>April 2000</td>
<td>1 July 2000</td>
</tr>
</tbody>
</table>

The following accounting standards are being developed with World Bank support.

<table>
<thead>
<tr>
<th>Draft / Intended Standard</th>
<th>IAS Equivalent</th>
<th>Timetable</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Borrowing Costs</td>
<td>IAS 23</td>
<td>2000</td>
</tr>
<tr>
<td>2 Leases</td>
<td>IAS 17</td>
<td>2000</td>
</tr>
<tr>
<td>3 Basic Transactions of Banking Industry</td>
<td>IAS 30</td>
<td>2000</td>
</tr>
<tr>
<td>4 Intangible Assets</td>
<td>IAS Framework</td>
<td>2000</td>
</tr>
<tr>
<td>5 Fixed Assets</td>
<td>IAS Framework</td>
<td>2000</td>
</tr>
<tr>
<td>6 Inventories</td>
<td>IAS 2</td>
<td>2000</td>
</tr>
<tr>
<td>7 Interim Financial Reporting</td>
<td></td>
<td>2000</td>
</tr>
<tr>
<td>8 Presentation of Financial Statements</td>
<td></td>
<td>2001</td>
</tr>
<tr>
<td>9 Foreign Currency Translation</td>
<td>IAS 21</td>
<td>2001</td>
</tr>
<tr>
<td>10 Donation and Government Grants</td>
<td>IAS 20</td>
<td>2001</td>
</tr>
<tr>
<td>11 Income Taxes</td>
<td>IAS 12</td>
<td>2001</td>
</tr>
<tr>
<td>12 Segmental Reporting</td>
<td></td>
<td>2001</td>
</tr>
<tr>
<td>13 Accounting for Liquidation</td>
<td></td>
<td>2001</td>
</tr>
<tr>
<td>14 Business Combinations</td>
<td>IAS 22</td>
<td>2001</td>
</tr>
<tr>
<td>15 Consolidated Financial Statements</td>
<td>IAS 27</td>
<td>2001</td>
</tr>
<tr>
<td>16 Impairment of Assets</td>
<td></td>
<td>2002</td>
</tr>
<tr>
<td>17 Earnings per Share</td>
<td>IAS 33</td>
<td>T.B.D.48</td>
</tr>
<tr>
<td>18 Discontinuing Operations</td>
<td></td>
<td>T.B.D.</td>
</tr>
</tbody>
</table>

48 To Be Determined.
Financial Reporting and Tax Compliance

The PRC’s traditional accounting system was similar to that of some European countries in that financial accounting and reporting was directly linked to the tax return. Consequently, the information needs of taxation authorities dominated those of other users. For instance, business management had little freedom over accounting choices.

The economic reforms have diversified financial reporting objectives beyond tax compliance and macro-economic administration. Financial reporting must now meet the needs of other parties who are interested in the financial performance and financial position of enterprises. The new accounting standards and systems allow enterprises to make the necessary adjustments to their financial statements when preparing their tax returns. At present, most listed enterprises adopt this practice. Moreover, the forthcoming development of the accounting standard on Income Tax (based on IAS 12) should reinforce this separation.

Public Sector Accounting Standards

The uniform accounting system currently governs public sector accounting practices however, a research study into the feasibility of developing accounting standards for government organizations and not-for-profit organizations will be conducted as part of the Accounting Reform Project.

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Consistency with International Accounting Standards

The MOF’s objective is to bring accounting standards into line with IAS while taking account of the PRC’s present laws and circumstances. The main difference between the Accounting Standards and IAS is that the PRC’s accounting standards offer reduced accounting choices. Overall, while the new standards largely conform to international standards, certain PRC-specific features can be observed, e.g., there is a high degree of government control over accounting matters; the standards are less complex and less detailed than western standards, and result in many complex liability issues being omitted; and there is broad adherence to the historical cost principle, although this is gradually changing.\(^{51}\)

Differences between IAS and the PRC’s accounting standards are presented in Table 9 – the comparative analysis was undertaken by Deloitte Touche Tohmatsu in 1999. None of these differences are significant – with a major exception – which is the requirement to agree; divergences from regulations (to comply with relevant accounting standards), and provisions for damaged or obsolete inventories, with the relevant authorities.

Table 9: A Comparison with International Accounting Standards (IAS)\(^ {52}\)

<table>
<thead>
<tr>
<th>Topic</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>IAS 1: Presentation of Financial Statements</td>
<td></td>
</tr>
<tr>
<td>o Compliance with relevant accounting standards</td>
<td>No requirement to state compliance. Divergences from regulations are permitted only with the consent of the relevant authority.</td>
</tr>
<tr>
<td>IAS 2: Inventories</td>
<td></td>
</tr>
<tr>
<td>o Measurement</td>
<td>Provisions for damaged or obsolete goods must be agreed with the relevant authority. However, this does not apply to shareholding companies.</td>
</tr>
<tr>
<td>IAS 21: Changes in Foreign Exchange Rates</td>
<td></td>
</tr>
<tr>
<td>o Transactions</td>
<td>As for IAS, except that the exchange rate on the first day of the month may also be used.</td>
</tr>
</tbody>
</table>

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\(^{52}\) Deloitte Touche Tohmatsu. 1999. An International Accounting Comparison: Focus on Asia Pacific. Volumes I and II.
# Topic Difference

**IAS 24: Related Parties**

**Application of the Standard**

Similar to IAS but only enterprises that are subject to control (not significant influence) from any of the specified individuals are regarded as related parties.

Table 10 illustrates the impact of differences between accounts prepared under the PRC statutory basis and International Accounting Standards.

**Table 10: Impact of Differences between Statutory Reporting and IAS**

<table>
<thead>
<tr>
<th>Figures for the year ended 31 December 1999</th>
<th>Anhui Guijing Distillery Co. Ltd.</th>
<th>Shenzen Health Mineral Water Co. Ltd.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Y’000s</td>
<td>Y’000s</td>
</tr>
<tr>
<td><strong>I. Profit after Taxation and Minority Interests:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>As reported in the statutory accounts of the Group</td>
<td>149,082</td>
<td>20,585</td>
</tr>
<tr>
<td>Reversal of (increases in) provision for doubtful debts</td>
<td>3,156</td>
<td>(200)</td>
</tr>
<tr>
<td>(Increase) provisions for obsolete inventories</td>
<td>..</td>
<td>(999)</td>
</tr>
<tr>
<td>(Increase) provision for diminution in long-term investments</td>
<td>..</td>
<td>(3,064)</td>
</tr>
<tr>
<td>Unearned profits from related-party transactions</td>
<td>..</td>
<td>(13,483)</td>
</tr>
<tr>
<td>Reserve write offs</td>
<td>..</td>
<td>(906)</td>
</tr>
<tr>
<td>Depreciation adjustments</td>
<td>1,747</td>
<td>..</td>
</tr>
<tr>
<td>Others</td>
<td>144</td>
<td>108</td>
</tr>
<tr>
<td>As restated for the Group to IAS</td>
<td>154,129</td>
<td>2,041</td>
</tr>
</tbody>
</table>

**II. Earnings per Share:**

| Using the Group’s statutory accounts | 0.63 | 0.13 |
| After IAS Adjustments | 0.66 | 0.01 |
Part Two. Auditing Standards

4. Independent Auditing Standards (Business Enterprises)

The CICPA is responsible for developing Independent Auditing Standards and these standards take effect once they have been approved by the MOF. The development process began in 1991 when CICPA issued the Rules on Audit Working Papers and Rules for CPAs on Capital Verification. In 1994, CICPA began drafting the independent auditing standards and laying down the framework which includes the basic and specific standards of independent auditing, the practice announcements of independent auditing, and the ethical standards of the profession. The first and second sets of independent auditing standards were promulgated in December 1995 and December 1996, respectively. In 1999, the third batch of Independent Auditing Standards was formulated and issued. Auditors are required to adhere to the standards, which are broadly based upon International Standards on Auditing and include:

- The General Independent Auditing Standard
- Specific Independent Auditing Standards:

  1 - Audit of Financial Statements
  2 - Audit Engagement Letters
  3 - Audit Planning
  4 - Audit Sampling
  5 - Audit Evidence
  6 - Audit Working Papers
  7 - Audit Report
  8 - Error and Fraud
  9 - Internal Controls and Audit Risk
  10 - Audit Materiality
  11 - Analytical Procedures
  12 - Using the Work of an Expert
  13 - Using the Work of other CPAs
  14 - Opening Balances
  15 - Subsequent Events
  16 - Related Parties and Transactions with Related Parties
  17 - Going Concern
  18 - Non-compliance with Laws and Regulations
  19 - Other Information Disclosed with Audited Financial Statements
  20 - Auditing in a Computer Information Systems Environment
  21 - Knowledge of the Entity’s Business
  22 - Considering the Work of Internal Auditing
  23 - Management Representations
  24 - Communication with Management

Article 35. CPA Law 1993.
ACCOUNTING AND AUDITING STANDARDS

• Independent Auditing Practice Pronouncements:
  1 – Verification of Capital Contributions
  2 – Management Letters
  3 – Special Considerations for the Audit of Small Businesses
  4 – Examination of Profit Forecasts
  5 – Special Considerations for the Audit of Consolidated Financial Statements
  6 – Audit Report on Special Purpose Engagements

• Other General Standards:
  - Professional Ethics
  - Quality Control
  - Continuing Professional Education

5. Government Audit Standards

In 1995, the CNAO issued the Government Auditing Standards, which were effective from 1 January 1997. The 38 standards cover three categories: (i) basic and fieldwork standards on government audits, (ii) directions for government audits, and (iii) audit management.

CNAO encountered problems with the implementation of the standards. First, audit staff had difficulty applying the standards in their actual audit work. Second, the standards dealt mainly with the auditing compliance aspects. The Audit Law 1994 also requires auditing of the authenticity and effectiveness of State revenues and expenditures. With the PRC’s shift to a market economy, many state-owned enterprises were being converted to shareholding companies, which meant that the CNAO had to make subsequent changes to its audit approaches and procedures. With the changing audit environment in the PRC, some of the existing standards and the Provisional Regulation on Shareholding Enterprises Audit were no longer relevant.

A preliminary assessment by the CNAO concluded that 27 of the 38 Government Auditing Standards needed to be reformulated and that the remaining 11 should not be retained. The assessment also concluded that an additional 23 standards needed to be prepared. This means that there will be a total of 50 auditing standards and procedures. ADB is

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54 Jointly issued in 1992 by the CNAO and the State Council’s Structural Reform Committee.
providing technical assistance to support this work, which includes a major training component.\textsuperscript{55}

\textsuperscript{55} TA No. 3103-PRC: Strengthening the Government Audit System, for $700,000 approved on 26 November 1998.
V. Accounting and Auditing Training

This chapter describes accounting and auditing education and training. It is structured as follows:

1. Introduction
2. Educational Coordination - describes the coordination of accountancy education within the PRC.
3. Higher Education - discusses the development of modern accountancy education in universities, the existing curriculum for undergraduate education, and the training of accounting lecturers and professors.
4. The National Accounting Institute (NAI) - describes the development of the specialized institute for continuing professional education.
5. The National Uniform Accountant Qualification - discusses the national uniform accountant qualification.
6. Auditor Training - describes the China National Audit Office's auditor-training activities.

1. Introduction

Most accounting and auditing skills are developed through practical on-the-job training and work experience. That aside, educational standards, particularly at the undergraduate level determine the basic level of knowledge that new entrants to the accounting market will have. The higher this level, the faster that skills will be developed.

2. Educational Coordination

Educational institutions are under the state's oversight. As such, accounting education reform not only relies on the efforts of accounting academics, but also on effective measures by the Ministry of Education. Over the past two decades, the Ministries of Finance and Education have exerted a great deal of influence over accounting education reform.

The Office of the Leading Group for National Training of CPAs was formed by eight ministries and commissions including: the MOF, the CNAO, the State Development and Planning Commission, the Office for Restructuring Economic Systems of the State Council, and the People's Bank of China. It provides leadership in the training of CPAs and relevant people across the PRC. The Office of the CPA Examination Committee, which was set up by the MOF, is responsible for
formulating principles and policies of the CPA examination, providing leadership in and organizing the examination affairs.

3. Higher Education

Universities Offering Accountancy Majors

Accountancy education has experienced dramatic developments since 1978, when the accounting major was reintroduced into universities and colleges. The number of higher education institutions increased from 21 in 1978 to 537 in 1996. The number of students in the institutions increased from 2,000 in 1978 to 125,892 in 1996. Before 1979, the teaching scheme for accounting was virtually a replica of the Soviet system. After soliciting the opinions of domestic and foreign experts, the Ministry of Education specified 11 core courses in finance and economics, and introduced a new curriculum in the late 1980s. The promulgation of the Revised Uniform Accounting System and the Basic Accounting Standard brought the PRC's accounting system into broad alignment with international practices. A wave of accounting education reforms followed. Changes involved the introduction of core courses covering: accounting principles; intermediate financial accounting; advanced financial accounting; management accounting; cost accounting; financial management; and auditing.

New textbooks were prepared and teaching materials were updated to reflect the new curriculum. Accounting academics recently examined accounting education and identified the following systemic weaknesses which, in the opinion of workshop attendees, are overstated: poorly-defined accounting education objectives, poor design of accounting majors, a weak curriculum system that does not fully reflect the needs of a mixed-market economy, poor compilation of textbooks, and lack of teaching consistency.

Specialized CPA-oriented Education Institutions

The 500 higher-education institutions that offer accounting majors include 23 universities and colleges that provide specialized CPA-
oriented education. These institutions produced 1,500 graduates in 1999. In addition, three more schools specializing in CPA education are to be opened in Beijing (National Accounting Institute), Shanghai (Shanghai Accounting Institute), and Guangdong in the next year.

Training of Accounting Lecturers and Professors

A rudimentary estimate, based on an average of ten teaching staff at each of the 500 institutions teaching undergraduate accounting, is that the PRC has about 5,000 accounting teachers (higher education). A ‘self-sponsored’ training approach is taken to their development. Accounting professors and lecturers do not however, receive formal training. For instance, the target-training group for the National Accounting Institute does not include accountancy professors and lecturers.

4. The National Accounting Institute (NAI)

A key element of the Government’s plan to upgrade professional accountants is the establishment of a large-scale national training center for accounting and finance training. The NAI will be a Beijing-located residential facility that can accommodate up to 1,500 students at one time. It will begin operations towards the end of 2000. The establishment and operations of the NAI are being partially funded by the World Bank Accounting Reform Project ( chapter VII refers).

The NAI will provide training and continuing education to the PRC’s 900,000 senior public and private sector accountants and finance managers. It will offer a wide selection of short courses on specific accounting and business topics and continuing professional education issues including accounting, auditing, taxation, information technologies, finance and enterprise management. Courses will range from one week to six weeks in duration, and instructors will be contracted from foreign and domestic accounting firms and universities. KPMG Canada has been contracted by the NAI to provide consulting services for the planning and design of curricula, programs, and courses relating to the training of accountants, other finance managers, and professionals.


5. The National Uniform Accountant Qualification

The National Uniform Accountant qualification, which is obtained by passing the National Uniform Accountant (NUA) examination, is the nonprofessional accounting qualification in the PRC. Candidates from both the public and the private sector sit the examination, which is held in high regard. The examination and the associated qualifications should not be confused with the unified CPA exam. CICPA is not directly involved in setting the NUA examination.

The NUA is administered by the MOF (Public Finance Authorities) and covers financial accounting, management accounting, auditing, and financial management. The NUA examination has four levels as follows: Accounting technician, Assistant accountant, Accountant, and Senior Accountant. NUA examination results are taken into account for promotion purposes. The MOF has recently introduced Continuing Professional Education (CPE) requirements for this qualification. The Rule on Continuing Education for Accountants stipulates that high-level accountants (Senior Accountants and Accountants) must complete a minimum of 68 hours of CPE per year. Other accountants must complete a minimum of 72 hours of CPE per year.

6. Auditor Training

The CNAO is responsible for auditor training and has established a subordinate institute, the Nanjing Audit Institute for this purpose. The Institute has over 400 staff and can cater to around 2,300 trainees at one time. Trainees are from the public and the private sectors.

With respect to its own auditors, the CNAO activities include three initiatives. First, the CNAO places high emphasis on on-the-job training and has established two training centers, in Beijing and in Shandong, to supplement these efforts. Second, the CNAO is developing a core-training program with World Bank assistance to develop the knowledge and skills of auditors in areas of modern audit theory and practices. Third, small numbers of CNAO staff have been seconded to foreign Supreme Audit Institutions (SAIs) in the past five years for varying periods (one to two years). These secondments have been successful in developing the foreign language, professional, and technical skills of the secondees and have benefited the CNAO.
VI. Government Budgeting and Accounting

This chapter describes government budgeting and accounting arrangements. For the purposes of this report, government is defined as central government organizations, local government organizations, and not-for-profit (NFP) organizations. In line with PRC criteria, state-owned enterprises (SOEs) are covered elsewhere along with private-sector organizations. The chapter is structured as follows:

1. Introduction
2. The Budget Cycle
3. Legal Framework for Budgeting and Accounting
4. Budgeting Roles and Responsibilities
5. Accounting Bases
6. Financial Reporting
7. Budgeting and Reporting Developments
8. Anti-Corruption Measures

1. Introduction

In the past 20 years, the PRC’s fiscal deficit has remained comparatively low and the country has made impressive progress in terms of economic and social outcomes. Among other things, the ability of the PRC’s economy to continue to deliver improved outcomes depends on how well it manages public expenditures.

In common with other centrally-planned economies that are transiting to a mixed-market economy, the PRC’s immediate focus has been on improving financial management arrangements for profit-oriented organizations. Given the scope of this task, it is not surprising that reforms to governmental financial management arrangements have been accorded a lower priority. That said, several issues have focused attention on governmental financial management arrangements in the past five years.

First, a growing body of economic literature supports strong linkages between government effectiveness and development outcomes. Second, local governments have limited authority to impose taxes, but central government transfers are generally inadequate to cover

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61 Not-for-profit organizations include schools, kindergartens, and hospitals. The PRC does not consider these as government organizations.

expenditures. Local governments bridge the resulting gap with extra-budgetary funds (surtaxes, levies and user charges accruing to government and administrative units).\(^{63}\) The inter-governmental fiscal arrangements associated with this situation are almost universally recognized as unsatisfactory and are perhaps the major cause of corruption amongst public officials. Third, there is growing identification of public sector wastage and mismanagement.

In recognition of these issues, the MOF, with support from the UNDP, the World Bank and the IMF, is currently examining options for budgetary reform with the intention of designing a comprehensive program to overhaul the PRC’s budget procedures.

2. The Budget Cycle

Figure 5 presents the indicative budget cycle as it currently stands. Note that spending ministries and units are not advised of their approved budgets until well into the year.

<table>
<thead>
<tr>
<th>Budget Stage</th>
<th>Month</th>
<th>Budget year (t)</th>
<th>t + 1</th>
</tr>
</thead>
<tbody>
<tr>
<td>I. Budget Preparation</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>State Council orders</td>
<td>t - 1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>drafting of the Budget and</td>
<td>Oct - Nov</td>
<td></td>
<td></td>
</tr>
<tr>
<td>sets out broad guidelines</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>for the draft</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Spending units, ministries</td>
<td>Oct - Dec</td>
<td></td>
<td></td>
</tr>
<tr>
<td>and local government</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>units compile their draft</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>budgets, which they submit</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>to MOF sectoral departments.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>MOF consults with ministries</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>and local governments on</td>
<td>Nov</td>
<td></td>
<td></td>
</tr>
<tr>
<td>budgets</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

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\(^{63}\) See, for instance:
## Government Budgeting and Accounting

<table>
<thead>
<tr>
<th>Budget Stage</th>
<th>Month</th>
<th>Budget year(t)</th>
<th>t + 1</th>
</tr>
</thead>
<tbody>
<tr>
<td>MOF drafts the central budget and compiles the state budget</td>
<td>Nov-Dec</td>
<td></td>
<td></td>
</tr>
<tr>
<td>MOF submits the budgets to the State Council for discussion</td>
<td>Jan</td>
<td></td>
<td></td>
</tr>
<tr>
<td>MOF presents draft budget to the Finance and Economics Standing Committee of the NPC</td>
<td>Feb</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Finance Minister presents budgets to the NPC</td>
<td>Mar</td>
<td></td>
<td></td>
</tr>
<tr>
<td>MOF passes on approved budgets to spending ministries</td>
<td>Mar-May</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Spending ministries pass on budgets to spending units</td>
<td>Mar-May</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

## II. Budget Implementation

- Spending takes place: Jan-Dec

## III. Reporting and Audit

- CNAO audits spending units' accounts: Jan-Mar
- Finance Minister presents preliminary final accounts to NPC: Mar
- CNAO audits central accounts: Jan-Apr
- Finance Minister presents final accounts to the NPC Standing Committee: Jun-Jul
3. **Legal Framework for Budgeting and Accounting**

The *Budget Law 1994* (effective from 1 January 1995) governs budgeting. It specifies budget roles and responsibilities, the budget process and the limits of the budget entity. Governments at different levels manage budgets separately – there are altogether five levels of budgets from the central level downwards. The *Accounting Law 1985* and the associated *Government Uniform Accounting System* govern accounting and reporting arrangements for government organizations.

4. **Budgeting Roles and Responsibilities**

The MOF and local government finance bureaus prepare the central budget and local budgets as well as final accounts. They are also responsible for the implementation and preparation of budget-adjustment plans. The State Planning Commission (SPC) and the People’s Bank of China (PBC) have prime responsibility for macroeconomic forecasting. Furthermore, the SPC prepares a rolling five-year investment plan. Macroeconomic forecasting, fiscal forecasting, investment planning, and budget preparation are inextricably intertwined, but the level of consultation between the MOF, the PBC and the SPC does not reflect this.

5. **Accounting Bases**

The aggregate budget is prepared on a cash basis. The Government also prepares a consolidated balance sheet that includes information on the level and composition of debt. This information is provided in publications, such as the *China Statistics Yearbook*. Individual budget units use modified cash accounting. Their reports include cash information that is consolidated for aggregate budgeting and reporting requirements. Not-for-profit organizations (e.g., schools, kindergartens, hospitals) have recently moved from cash accounting to a modified form of accrual accounting.

6. **Financial Reporting**

The uniform accounting system for Government organizations sets out reporting requirements. The central treasury reports daily, monthly and annually to the MOF – daily and monthly reports consist of aggregate
numbers on revenues, expenditures and account balances. Spending units report monthly and annually to supervising ministries, which compile reports to the MOF. Table 11 presents details of the external financial reports prepared by public sector organizations. There are no set requirements for internal financial and performance reports.

Table 11: Financial Reports

<table>
<thead>
<tr>
<th>Type of Organization</th>
<th>Composition of Financial Statements</th>
</tr>
</thead>
<tbody>
<tr>
<td>Government Agencies</td>
<td>o Balance sheet</td>
</tr>
<tr>
<td></td>
<td>o General statement of revenues and expenditures</td>
</tr>
<tr>
<td></td>
<td>o Detailed breakdown of expenditures, and</td>
</tr>
<tr>
<td></td>
<td>o Explanations.</td>
</tr>
<tr>
<td>Not-for-profit Organizations</td>
<td>o Balance sheet</td>
</tr>
<tr>
<td></td>
<td>o Statement of revenues and expenditures</td>
</tr>
<tr>
<td></td>
<td>o Statement of investment in basic construction</td>
</tr>
<tr>
<td></td>
<td>o Supplementary statements</td>
</tr>
<tr>
<td></td>
<td>o Notes</td>
</tr>
<tr>
<td></td>
<td>o Detailed breakdown of expenditures, and</td>
</tr>
<tr>
<td></td>
<td>o Explanations.</td>
</tr>
<tr>
<td>Public Financial Institutions</td>
<td>o Balance sheet</td>
</tr>
<tr>
<td></td>
<td>o Report against budget (the statement of budget implementation)</td>
</tr>
<tr>
<td></td>
<td>o Explanation of activities, and</td>
</tr>
<tr>
<td></td>
<td>o other supplementary statements.</td>
</tr>
</tbody>
</table>

7. Budgeting and Reporting Developments

A project to reform budget arrangements was initiated in 1998 in Hebei province. The project will alter the timing and focus of the budget process, and make budget reports more comprehensive. The MOF is in the process of developing plans for computerizing government budgeting and reporting. These changes may also include cash management reforms, the introduction of a Single Treasury Account, and the reformation of reporting classifications.

There are currently no firm plans for government organizations to report in accordance with International Standards. However, a research study into the feasibility of developing accounting standards for
government organizations will be conducted as part of the Accounting Reform Project (chapter VII refers).

8. Anti-Corruption Measures

The Government launched a campaign against corruption, embezzlement, and illegal use of funds in 1998, which continued in 1999. The Anti-corruption Conference of the State Council in January 1999 confirmed the anti-corruption drive as one of the Government's top priorities. The Government intensified measures to fight corruption, introducing measures to abolish affiliations between Government and business, and the military and business. There is an ongoing campaign to inspect public works and to hold officials personally accountable for shoddy construction, misallocation of funds and corruption. In June 1999, the Government announced that it would tighten regulation of the central budget and set up a body to punish corrupt officials based on strict auditing. The new auditing rules that have been adopted in this respect require that officials at the national level and below, as well as the senior managers of SOEs, be audited after the person is dismissed, resigns, or retires.

The Government has also recognized that the use of transparent bidding processes can help to create an environment that will reduce the opportunities for corruption. The Tendering and Bidding Law 1999, mandates transparent public bidding for large infrastructure projects, and projects involving loans or aid funds from international organizations or foreign governments. A Government Procurement Law is included in the legislative work program.
VII. Donor Assistance

This chapter describes donor-coordination mechanisms and discusses donor activities in relation to financial management and governance arrangements. It is structured as follows:

1 - Overview
2 - Coordination Mechanisms
3 - Asian Development Bank
4 - International Monetary Fund (IMF)
5 - The World Bank
6 - United Nations (UNDP)
7 - Australia (AusAID)
8 - Canada (CIDA)
9 - Germany (GTZ)
10 - Others

1. Overview

Table 12: Overall External Assistance to the PRC (1996-1999)

<table>
<thead>
<tr>
<th>External Source</th>
<th>Period</th>
<th>Ordinary Loans</th>
<th>Soft Loans</th>
<th>Mixed Credit / Export Credit</th>
<th>Grant Assistance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Multilateral</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>ADB</td>
<td>1998</td>
<td>1,202.0</td>
<td>..</td>
<td>23.5</td>
<td></td>
</tr>
<tr>
<td>UNDP</td>
<td>1996–2000</td>
<td>..</td>
<td>..</td>
<td>194.1</td>
<td></td>
</tr>
<tr>
<td>World Bank</td>
<td>FY 1998/99</td>
<td>1,676.4</td>
<td>447.6</td>
<td>..</td>
<td></td>
</tr>
<tr>
<td>Bilateral</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Australia</td>
<td>FY 1998/99</td>
<td>..</td>
<td>..</td>
<td>85.7</td>
<td></td>
</tr>
<tr>
<td>Canada</td>
<td>1998</td>
<td>..</td>
<td>..</td>
<td>47.4</td>
<td></td>
</tr>
<tr>
<td>France</td>
<td>1997</td>
<td>..</td>
<td>50.1</td>
<td>..</td>
<td></td>
</tr>
<tr>
<td>Germany</td>
<td>1998</td>
<td>..</td>
<td>601.8</td>
<td>12.8</td>
<td>76.1</td>
</tr>
<tr>
<td>Italy</td>
<td>1996–1998</td>
<td>..</td>
<td>235.8</td>
<td>14.0</td>
<td></td>
</tr>
<tr>
<td>Japan</td>
<td>FY 1998</td>
<td>7915</td>
<td>3,714.3</td>
<td>140.0</td>
<td></td>
</tr>
<tr>
<td>Spain</td>
<td>1997</td>
<td>..</td>
<td>600.0</td>
<td>N a</td>
<td></td>
</tr>
<tr>
<td>United Kingdom</td>
<td>1999</td>
<td>..</td>
<td>23.7</td>
<td>N a</td>
<td>N a</td>
</tr>
<tr>
<td>United States</td>
<td>1997</td>
<td>..</td>
<td>700.0</td>
<td>..</td>
<td></td>
</tr>
</tbody>
</table>

The PRC receives the lowest per capita level of external assistance of the seven countries participating in RETA-5877 (Table 13 refers).

Table 13. Official Development Assistance

<table>
<thead>
<tr>
<th></th>
<th>Cambodia</th>
<th>People's Republic of China</th>
<th>Mongolia</th>
<th>Pakistan</th>
<th>Papua New Guinea</th>
<th>Uzbekistan</th>
<th>Vietnam</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dollars per capita</td>
<td>36</td>
<td>2</td>
<td>99</td>
<td>5</td>
<td>78</td>
<td>6</td>
<td>13</td>
</tr>
<tr>
<td>Percentage of GNP</td>
<td>12.1</td>
<td>0.2</td>
<td>26.7</td>
<td>10</td>
<td>7.8</td>
<td>0.5</td>
<td>4.1</td>
</tr>
</tbody>
</table>

2. Coordination Mechanisms

The State Planning Commission (SPC), under the guidance of the State Council, acts as the overall coordinating arm of the Government, including reviewing and approving projects proposed for external assistance. The Ministry of Finance coordinates with major lenders to the PRC. The Ministry of Foreign Trade and Economic Relations coordinates with agencies that provide grant financing. In addition to government coordination, the UNDP office in Beijing published a report on development assistance in 1995, based on information submitted by major donors. This exercise has not been repeated.

3. Asian Development Bank

As of 31 December 1999, cumulative net lending to the PRC totaled $9,300 million with contract awards and disbursements reaching $5,300 million and $5,000 million, respectively. ADB has also provided technical assistance for 328 projects totaling $166 million as of 31 December 1999 – project preparatory TAs (PPTAs) accounted for 26 percent.

ADB is supporting broad governance activities through the technical assistance program. Support for the drafting of the Public Procurement Law, its Standard Bidding Documents and Implementing Regulations; improved audit standards and procedures; strengthening the inspection function; support for the Bankruptcy Law and other key

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ADB, World Bank, JBIC, and most bilateral export credit agencies.

economic laws; and construction industry regulations and registration procedures are a few examples.\textsuperscript{68}

More specifically, ADB is initiating policy dialogue to support the Government in the development of an efficient and commercially oriented banking sector. To achieve this goal, the Government needs to: (i) establish a sound legal framework, (ii) enhance corporate governance and raise accounting and financial disclosure standards, (iii) improve banking regulatory and supervisory systems and liquidity management, (iv) improve legislation for bankruptcy and loan foreclosures, (v) develop efficient market infrastructures for payments, clearing, and settlements, (vi) deregulate interest rates, (vii) develop an effective strategy for debt resolution of state-owned enterprises, and (viii) ensure general public confidence in the banking system.\textsuperscript{69}

The PRC was selected as the first country for a broad-based Country Assistance Program Evaluation (CAPE). In general, ADB considers that the PRC portfolio is performing well, and that physical implementation is proceeding on schedule. As of 31 December 1999, audited accounts were due for 34 loans. Of these, 22 had complied, 10 complied late by less than six months, and two had not yet complied.\textsuperscript{70}

Loan Projects

No loans for financial governance or capacity building have been issued, nor are any planned. However, until recently, technical assistance to strengthen financial management within executing agencies was often provided alongside loans.\textsuperscript{71} Including covenants in loan agreements that require executing agencies to maintain a certain standard of financial management practices has superseded this policy.


\textsuperscript{69} Ibid. p. 20.


Technical Assistance
Along with the assistance provided to executing agencies to strengthen their financial management capacity, assistance has also been provided to coordinating agencies to improve their loan administration and accounting procedures (in relation to ADB projects). The major initiatives that ADB has supported, or intends to support in the future, are as follows:

**Pipeline 2003: Financial Strengthening of Water Utilities**
The Ministry of Commerce is likely to be the executing agency for this TA for which $600,000 has been allocated. The TA will involve the development of a sector-specific Accounting Information System. This is likely to include: the development of a generic set of internal management and external reporting formats, the development of guidelines on internal controls and financial management practices, and associated training materials.

**Pipeline 2003: Governance Reform**
The objectives of, and the executing agency for, this TA have yet to be determined. $500,000 has been set aside.

**Pipeline 2002: Governance Reform**
The objectives of, and the executing agency for, this TA have yet to be determined. The amount of $500,000 has been set aside.

**Pipeline 2001: Strengthening Accounting Profession**
CICPA is likely to be the executing agency for the TA for which $600,000 has been allocated. The recommendations in this report will be considered when the details of this TA are decided.

**TA No. 3103-PRC: Strengthening the Government Audit System**
This TA for $700,000, which was approved on 26 November 1998, began in 1999 and will continue through to 2001. It is providing assistance to help strengthen the Government’s audit system to conform to the

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requirements of the Audit Law and, as far as practicable, International Standards on Auditing (ISAs). The particular objectives are to assist CNAO to: (i) formulate government auditing standards and procedures, and (ii) design and implement an audit training program to promote full and consistent adherence to such auditing standards. Under the first part of the TA, the existing 38 audit standards are being reviewed with lessons being drawn from the implementation of these standards and the Audit Law. The revised and additional standards will, as far as practicable, conform to IFAC Guidelines and ISAs. Under the second part of the TA, training programs to promote full compliance with the auditing standards and procedures will be designed and delivered.

**TA No. 2509-PRC: Strengthening Financial Management in Provincial Power Utilities**
This TA for $600,000 was approved on 22 December 1995. It involved the development of prototype Accounting Information Systems for power utilities (in particular, a generic model for internal management reporting supported by training materials).

**TA No. 2257-PRC: Enterprise Accounting System Reform**
This TA for $467,000 was approved on 21 December 1994. The objective of this TA was to provide training and capacity building for SOE financial managers.

This TA for $600,000 was approved on 21 February 1991. It improved the CNAO’s capacity to audit externally-assisted projects, including those of ADB. The objectives of the TA were to (i) improve the auditing standards, particularly those of the Foreign Fund Application Audit Department (FFAAD) and bring them up to international levels, (ii) upgrade the skills of FFAAD staff, both at headquarters and in selected provincial bureaus, and (iii) enhance FFAAD’s operational efficiency by recommending measures for office automation. The TA was generally successful and achieved the stated objectives. Major outputs were the Audit Manual and Sectoral Guidelines that were well received, and the provision of international training, which was well utilized.
Other Technical Assistance
The above TAs were directly related to improving accounting and auditing. The following TAs are relevant to broader financial management and governance arrangements:

- Pipeline 2002: Evaluation of Methods and Standards for Efficient Corporate Management (MOF – $700,000). This TA will assist the MOF to improve its monitoring of SOEs. It is likely that it will assist in the development of a financial monitoring regime.

- Pipeline 2002: WTO Membership and Law Reform (MOFTEC – $500,000). This TA will support the translation of laws into English so that they can be relied upon in court.

- Pipeline 2001: Strengthening Capacity of Public Financing (MOF – $600,000). This TA will support fiscal reform initiatives, for instance, a review of inter-governmental fiscal relations.

- Pipeline 2000: Government Procurement Law (NPC – $500,000). This TA will support the development of legislation covering public sector procurement.

- Pipeline 2000: Implementation of the Tendering and Bidding Law and Related Regulations (SDPC – $500,000). The tendering and bidding law was enacted in 1999 and applies to large infrastructure projects. This TA will support the implementation of that law and the development of associated regulations.

- TA No. 3304-PRC: Capacity Building of the Capital Markets' Regulatory System. This TA for $1 million, which was approved on 24 November 1999, will support the development of regulations stemming from the passing of the 1999 Securities Law. These regulations will cover issues such as financial disclosure requirements.

- TA No. 3279-PRC: Development of Economic Laws. This TA for $14 million, which was approved on 19 October 1999, will involve the review of seven laws and regulations, just before their final consideration. The laws are likely to include: redrafts of the bankruptcy law, the companies law, the trust law, the social security law, the regulations for closing insolvent financial institutions, and the administrative licencing law.

- TA No. 2845-PRC: Establishment of National Procurement Regulations for the Public Sector. This TA for $565,000, which was approved on 20 August 1997, produced six sets of draft regulations and three sets of
sample bidding documents that contain provisions relating to
corrupt and fraudulent practices.

- TA No. 2118-PRC: A Study of Sub-Provincial Fiscal Relations. This TA
  for $500,000, which was approved on 28 June 1994, examined
  federal-provincial fiscal relations and associated revenue and
  expenditure assignments. It also supported the publication of a
  book on fiscal management in the PRC.\textsuperscript{73}

4. International Monetary Fund (IMF)

China was a founding member of the IMF in 1944 and resumed its
membership in 1980. The IMF has provided ongoing technical
assistance for government budgeting and is heavily involved with the
World Bank and the UNDP with the public expenditure management
and treasury management project.

5. The World Bank

When the World Bank was established in 1944, China was one of the
founding members. The PRC resumed its membership in May 1980. The
World Bank’s lending program has mirrored the Government’s efforts to
cope with the Asian financial crisis. Several projects in 1999 supported
critical reform initiatives of the new government, such as reforms of the
accounting system, pension system, State-owned enterprises and
container transport.\textsuperscript{74}

The World Bank has been the major provider of external assistance
in relation to the development of accounting and auditing arrangements.
The World Bank assistance for public finance reform has included the Fiscal
Technical Assistance Project (1995), which helped develop the National
Tax Administration, a central-provincial grants scheme, and budget
management systems, as well as build the PRC’s capacity to analyze tax
policy.

\textsuperscript{73} Wong, Christine, Christopher Heady, and Wing Woo. 1995. Fiscal Management

\textsuperscript{74} Yukon Huang (Director of the World Bank China Program). 8 July 1999. World
Bank Press Release.
Accounting Reform and Development Project (1999–2004)\textsuperscript{75,76}

The World Bank has provided a $27.4 million loan and a $5.7 million equivalent credit to assist in the modernization of the PRC’s accounting system. The total project cost is $85 million – the Government is financing the balance of $52 million. CICPA and the CASC are the project implementing agencies. The project is building upon the Financial Sector Technical Assistance (FSTA) project (see below). Its objectives are to further strengthen the caliber and training of members of the accounting profession and to develop and promulgate additional accounting standards. The project has three components as follows:

**Establish National Accounting Institute (NAI) ($79.1 million)**

The key element of the Government’s plan to upgrade professional accountants is the establishment of a large-scale national training center for accounting and finance training. The NAI will be a Beijing-located residential facility that can accommodate up to 1,500 students at one time.

The NAI will provide training and continuing education to the PRC’s 900,000 accountants and finance managers.\textsuperscript{77} It will offer a wide selection of short courses on specific accounting and business topics and continuing professional education issues. The minimum course length will be five days - instructors will be contracted from foreign and domestic accounting firms and universities.

The World Bank assistance will focus on the provision of educational and training equipment and materials, curriculum design, financing of high-level trainers who can help build local training capacity, and the provision of overseas training for educators. The contract for the planning and design of the curriculum, programs and training courses was signed with KPMG Canada (who will be assisted by experts from the Canadian Institute of Chartered Accountants) on 11 May 2000.

**Institutional Strengthening of CICPA ($1.3 million)**

The World Bank considered that, because of its access to advisory resources from other accounting societies and from its membership base,
CICPA was not in need of operational technical assistance. The World Bank assistance is providing short-term support for computers, software and other equipment essential to the expanding operations of CICPA. Bidding documents were prepared for release in mid-2000.

**Accounting Standard Development and Dissemination ($4.3 million)**

This component is supporting the Government's ongoing efforts to develop and promulgate accounting standards based upon Internationally Accounting Standards (IAS). In respect of this, assistance to the China Accounting Standards Committee (CASC) has four sub-components:

1. **Supporting the promulgation of the remaining 17 standards that were prepared under the FTSA.** Funds are being provided for the delivery by consultants of four high-level seminars (1999-2002) that will disseminate information and provide training to senior provincial accounting and finance policy makers – each seminar will address the most recently-issued batch of standards. A training manual and videocassette will also be prepared in relation to each standard.\(^{78}\)

2. **Preparing, promulgating, disseminating around 17 new general and sector/industry-specific standards.** A research study into the feasibility of developing accounting standards for government and not-for-profit organizations will also be supported.

3. **Establishing an Accounting Standards Public Information Center.** This component will support the procurement/development of library books, periodicals, office equipment, and a web site.

4. **Providing institutional support to the CASC.** This support will include three 14-day annual study tours together with longer-term overseas training and secondments for Committee members. It will also support the procurement of information technology and presentational equipment.

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\(^{78}\) The contract for technical advice on accounting standards was signed with Deloitte Touche Tohmatsu in March 2000.
FINANCIAL MANAGEMENT AND GOVERNANCE ISSUES IN THE PRC

Technical Assistance to the CNAO (1997–2000)

The World Bank is providing technical assistance of $487,000 to the Foreign Funds Application Audit Department (FFAAD) of CNAO to:

• establish a management information system that will enable the FFAAD to efficiently and accurately collect and distribute audit data among its nationwide network of offices
• familiarize senior FFAAD management with the experiences of Supreme Audit Institutions in performance auditing
• enhance the skills and knowledge of selected senior FFAAD auditors in specialized areas of accounting and auditing practice with an emphasis on performance auditing, and
• establish a core-training program to develop the knowledge and skills of auditors in areas of modern audit theory and practices. This includes the preparation of a manual on performance auditing and the first draft of the manual was completed in July 2000.


The objective of the Fiscal Technical Assistance Project, which was originally for $50 million, is to assist in implementing fiscal reforms and preparing for future reforms. The project will support the fiscal reforms by: (a) developing and implementing a new tax administration; (b) strengthening capacity for tax policy analysis; (c) developing and implementing a central-provincial grants scheme; and (d) improving budgetary process and practices.

Despite the 1995 starting date, very little was accomplished under this project until April 2000, with completion of a comprehensive Public Expenditure Management (PEM) Review, by a World Bank team. A plan to reform and computerize government budgeting and accounting systems and procedures, is currently being developed by the MOF, the World Bank, and the IMF – the plan is drawing on the findings of the PEM, and will be implemented using the funding set aside in the Fiscal Technical Assistance Project.

Reference TF 27549.
Financial Sector Technical Assistance (FSTA) Loan (1992–)\textsuperscript{80}

This credit for $60 million equivalent remains the largest World Bank operation in the PRC’s financial sector in recent years. Around $39 million is disbursed, the rest is fully committed. Most components have been completed. Implementation of the pilot China National Payments System is proceeding. An assessment of the primary and secondary government bond market was initiated in November 1999.

In the period 1992–1995, using funds from a component of the FSTA credit, the MOF’s Task Force on Accounting Standards prepared 25 accounting standards in harmony with International Accounting Standards (IAS). The first of these standards was promulgated in May 1997. The 24-member Task Force was set up within the MOF’s Department of Accounting, to work alongside an international firm of accounting consultants (Deloitte Touche Tohmatsu), to draft new accounting standards for the PRC. In March 1998, the Government drew on the experience gained by the Task Force to establish the China Accounting Standards Committee (CASC).

6. United Nations (UNDP)

The UNDP works in close cooperation with the World Bank and the IMF. In particular, the UNDP provides supplementary technical assistance.

In May 1999, the UNDP supported a study tour for CNAO officials to European countries to examine fiscal and taxation auditing practices\textsuperscript{81}. The UNDP supported the development of a master plan for reforming aspects of public administration reform\textsuperscript{82}.

7. Australia (AusAID)

Australia is supporting a five-year $11 million, capacity-building program to help strengthen the public sector. The program aims to enhance the ability of institutions to develop and implement policies relating to the transition to a market economy, and improve their capacity to deliver public sector services. Assistance is being provided through technical assistance, study tours, short-term training in


\textsuperscript{81} UNDP Reference: CPR / 98 / 002.

\textsuperscript{82} UNDP Reference: CPR / 96 / 510.
Australia and in the PRC, and personnel placements in Australia. Around 15 government agencies have taken part in the program since it began in 1998. The following financial management activities have been undertaken.

The program has supported Australian training for nine middle-ranking managers from the China National Audit Office (CNAO). The training, which took place from March to August 2000, was designed to assist CNAO improve the quality and efficiency of the financial statement audits of SOEs. The suitability of computerized audit approaches was also investigated. A key output will be a Financial Statements Audit procedures manual for conducting audits of SOEs. Multimedia and information technology specialists have worked with CNAO who will produce highly interesting interactive training material for CNAO's auditors conveying the content of this manual.

In addition to assisting the Ministry of Finance (MOF) on human resource management practices, the program has supported several study tours and training initiatives for MOF officials. In 1999, seminars were conducted in China on Australia's leading-edge budgeting practices (for instance, accrual-based budgeting). In July 2000, a study tour to Australia examined capital budgeting (for instance, cost-benefit analyses, and a policy-driven budget allocation process).

8. Canada (CIDA)

In the late 1980s, CIDA provided early support to CNAO in terms of how to train auditors. More recently, CIDA has supported the Certified General Accountants (CGA) Association of Canada CPA training program. This training program is conducted in the PRC. CIDA's funding of this initiative finished at the end of 1999. CGA is continuing the program, which is now self-funding.

To be awarded the CGA designation, students must not only complete the program of professional studies, but also satisfy CGA-Canada's practical experience requirement and earn an undergraduate university degree. The first members earned certification as CGAs in 1996. The program is operated out of seven Chinese universities. Around 100 CGA memberships had been awarded by the end of 1999.

9. Germany (GTZ)

GTZ is providing ongoing support to the CNAO, in particular, to the Continuing Education Centers. The support is being provided by the
DONOR ASSISTANCE

German Audit Office and involves the provision of equipment (information technology, office equipment, and training equipment), short-term experts, and in-Germany training.

10. Others

While the Japan International Cooperation Agency (JICA) has provided substantial assistance concerning management training and SOE restructuring, there has been no direct assistance in terms of financial management. The PRC is a non-presence country in terms of USAID operations.

A number of national accounting organizations have cooperative linkages with the Chinese accounting profession, for instance:

- the Hong Kong Society of Accountants (HKSA) provides significant assistance, for instance the quarterly journal, China Accounting and Finance Review, is published with the assistance of the HKSA.
- the Certified General Accountants (CGA) Association of Canada conducts an in-country certification program (see section 8 above).
VIII. Issues and Recommendations

This chapter presents the issues and recommendations that are associated with gaps or weaknesses in accounting and auditing arrangements. The issues and recommendations are divided into two parts as follows.

- **Part One**: Where the matter referred to may be considered and, if any action were to be taken, this would be better achieved with external assistance.

- **Part Two**: Where the matter referred to may be considered and, if any action is to be taken, this may be achieved without the need for external assistance.

**Part One. Where Donor Assistance Might be Appropriate**

1. **Professional Supervision of CPA Firms (Quality Control)**

The Rectification Campaign was a short-term, albeit successful, measure. On an ongoing basis, improved supervision can have significant impacts on the quality and availability of professional services. The Chinese Institute of Certified Public Accountants' (CICPA) current supervisory resources are minimal in comparison to the number of CPAs and CPA firms (in January 2000, on average, three staff in each provincial CPA institute were responsible for supervisory activities). Moreover, CICPA considers that the professional knowledge and experience of supervising staff falls short of the necessary requirements for supervisory work.

CICPA is strengthening professional supervision. Initiatives include the establishment of provincial supervision teams, development of reporting systems in the key finance, securities and insurance sectors, and experimental introduction of peer review systems. In the future, the Institute intends to: (i) further strengthen the supervision and control of auditing in key fields (such as financial-institution audits), (ii) establish a business reporting and recording system for accounting firms, (iii) improve CICPA’s monitoring and quality-control capacity, (iv) formulate and improve supervisory regulations and widen the peer review system, and (v) continue to expose professional failures in the media.
CICPA has requested assistance to improve supervisory mechanisms.\textsuperscript{83} This report supports the Institute's proposal for assistance to undertake a project to improve the profession's supervisory regime. CICPA proposes that the project be led by the Vice Secretary-General and organized by the Registration Department.

It is recommended that a project to improve professional supervision be undertaken. The project would involve:

- studying the existing structures and processes of CPA firms,
- examining, and drawing useful lessons from international experience with regards to supervisory regimes (including peer review regimes),
- designing a supervisory system for the PRC that takes account of the country's situation and provides sufficient flexibility to deal with environmental changes,
- implementing the supervisory system and associated reporting systems,
- reviewing and, where necessary, revising CPA legal responsibilities and associated disciplinary regulations, and
- improving the competence and effectiveness of managers with supervisory responsibilities through training.

2. CPA Examination System Reform

The Uniform CPA Examination was introduced in 1991. Since then, the ever growing number of examination candidates is placing increasing pressure on management of the examination. Some 530,000 candidates sat the exam in 2000. There are major issues with the existing examination system:

- management systems are predominantly manual (e.g., distribution of papers and notification of results).
- examinations are held only once each year. This is not ideal for potential candidates and exacerbates organizational issues. The introduction of improved management techniques and technology would enable examinations to be held at least twice each year.

\textsuperscript{83} CICPA. A Proposition for Technical Assistance to Reform the Chinese CPA Profession and to Enhance the Institution's Organizational Construction. July 2000.
ISSUES AND RECOMMENDATIONS

examination preparation, grading procedures, and general organization practices do not meet international standards. Criticisms have been made that passing the examination is a test of memory, not of competence and knowledge.

CICPA has requested assistance to reform the examination system. CICPA proposes that the project be led by the Vice Secretary-General and be organized by the Examination Department. This report supports CICPA’s request.

It is recommended that a project to improve the CPA examination system be undertaken. The project would involve:

- investigating design options for examination systems,
- establishing a database of examination questions,
- reviewing and reforming the grading system,
- examining the feasibility of, and options for, developing an online examination system (in cooperation with the Ministry of Finance’s Institute of Fiscal Science),
- developing suitable examination software, and
- implementing changes to management procedures.

3. Organization for Accountants (Non-CPAs)

CICPA represents accountants in public practice and essentially has one individual membership category – that of the CPA (either practising or non-practising). However, in addition to CPAs, the PRC has around a further twelve million accountants. These accountants work in the public and private sectors and are classified into four levels: Senior Accountant, Accountant, Assistant Accountant, and Accounting Technician. Qualifications are gained by passing the National Uniform Accountant (NUA) examination.

These accountants have no professional organization. One option would be to create subsidiary membership categories within CICPA.

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84 CICPA. A Proposition for Technical Assistance to Reform the Chinese CPA Profession and to Enhance the Institution’s Organizational Construction. July 2000.

85 In February 1999, UNCTAD issued Education Guidelines – agreed by 146 countries of which China is one. The Standards spell out the various subjects in each examination and the level of knowledge required.

86 An Internet-delivered examination system, such as that used for Microsoft Certification Examinations, would solve many of the problems that have been identified. Moreover, such a system would improve linkages to outlying regions.
but CICPA does not support this approach. The establishment of a professional body for this group of accountants would provide a transitional route for aspiring CPAs. It would also raise the societal status of public sector accountants, and improve their knowledge and competence.

**It is recommended that:**
- a new professional body be established to represent accountants who are not in public practice.

**4. National Uniform Accountant Examination System**

The vast majority of the PRC’s accountants qualify through the National Uniform Accountant Examination. There are around twelve million of these accountants. As with the Uniform CPA Examination, there are major issues with the existing examination system:
- management systems are predominantly manual (e.g., distribution of papers and notification of results).
- examinations are held only once each year. This is not ideal for potential candidates and exacerbates organizational issues. The introduction of improved management techniques and technology would enable examinations to be held at least twice each year.
- examination preparation, grading procedures, and general organization practices do not meet international standards. Criticisms have been made that passing the examination is a test of memory, not of competence and knowledge.

The Accounting Regulatory Department (ARD) of the Ministry of Finance has requested assistance to reform the National Uniform Accountant Examination system. They propose that the Director of the ARD lead the project. This report supports their request.

**It is recommended that a project to improve the National Uniform Accountant Examination system be undertaken. The project would involve:**
- investigating design options for examination systems, 87
- establishing a database of examination questions,
• reviewing and reforming the grading system,
• examining the feasibility of, and options for, developing an on-line examination system (in cooperation with the MOF’s Institute of Fiscal Science),
• developing suitable examination software, and
• implementing changes to management procedures.

5. China Institute of Internal Auditing: Certification

There is currently no specific internal auditor designation, which contributes to the lack of status of internal auditors in their resident organizations. The adoption of a CIIA certification would help to elevate the perceived value and prestige of internal auditors. Furthermore, the exposure of candidates to examination materials will facilitate the modernization and upgrading of internal auditing practices.

There are synergies between the proposed improvements to CICPA’s proposed improvements to the Uniform CPA Examination and the development of the CIIA examination and certification process. In particular, the same technology could be used.

It is recommended that a project to develop CIIA certification and examinations be undertaken. The project would involve:
• developing a PRC-specific qualification (certification) for internal auditors, and
• developing a PRC-specific examination system for internal auditors.

6. Development of CICPA Training Materials

The CICPA has been active in developing training materials. However, the rapidly changing environment combined with the dramatic increase in Institute members and examination candidates are major challenges. Multimedia and Internet-based technologies present options to prepare effective interactive training materials that are easily redeveloped to reflect the changing environment and can easily be distributed to far-flung regions.

88 An Internet-delivered examination system, such as that used for Microsoft Certification Examinations, would solve many of the problems that have been identified. Moreover, such a system would improve linkages to outlying regions.
CICPA has requested assistance to improve the development and delivery of training materials. CICPA proposes that the project be led by the Vice Secretary-General and be organized by the Training Department. This report supports the request.

It is recommended that a project to improve training materials for CPA continuing professional education. The project would involve:

- studying options for preparing and providing training materials to CPAs
- developing a medium to long-term plan for developing continuing professional education
- studying options for developing and delivering training materials using modern technology
- developing training materials, and
- reviewing the core course teaching materials at the 23 pilot colleges and universities that have established CPA programs.

Furthermore, it is recommended that the CICPA:

- review existing interactive accounting training materials (such as those developed by New York Stern University in association with John Wiley and Sons),
- study the CNAO’s experiences with the development of Multi-media training materials (as supported by AusAID - chapter VII refers),
- study the development of video-based training materials under the Accounting Standards Reform Project (as supported by the World Bank - section chapter VII refers), and
- consider Internet-based provision of the materials.

7. Plan for Strategic Development of the CPA Profession

The PRC’s accountancy profession is confronting many complex issues. These issues include training, independence, and legal liability. To date, CICPA has dealt with issues in a competent, coordinated fashion – at least to the extent that its operating environment allows. The profession’s challenge is to deal with future issues in a similar fashion – a medium to long-term plan would support this.

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89 CICPA. A Proposition for Technical Assistance to Reform the Chinese CPA Profession and to Enhance the Institution’s Organizational Construction. July 2000.
CICPA has requested assistance to support the preparation of a medium to long-term development plan for CICPA and the accountancy profession. The plan would encompass professional development goals, professional administration, and administrative structures and systems.\textsuperscript{90} The CICPA proposes that the project be led by the Secretary-General and be organized by the Director of the Comprehensive Department. This report supports the Institute's proposal for assistance to formulate a medium to long-term development plan and recommends that the plan should make reference to the issues and recommendations contained in this report.

It is recommended that a project to develop a strategic plan for the development of accounting profession be developed. The project would involve:

- researching the present situation of the Chinese CPA profession,
- analyzing existing problems,
- examining and drawing useful lessons from international experience in terms of the development of the accountancy profession, and
- using this information and the associated analyses to formulate a medium to long-term development plan for CICPA and the accountancy profession.

8. CNAO Training and Capacity Building

The China National Audit Office (CNAO) is developing a core-training program with World Bank assistance to develop the knowledge and skills of auditors in areas of modern audit theory and practices. In addition, the Nanjing Training Institute has been established.

Small numbers of CNAO staff have been seconded to foreign Supreme Audit Institutes (SAIs) in the past five years for varying periods (one to two years). These secondments have been successful in developing the foreign language, professional, and technical skills of the secondees and have benefited the CNAO.

It is important that the core-training program be effectively implemented. Once the program has been implemented, the CNAO

\textsuperscript{90} CICPA. A Proposition for Technical Assistance to Reform the Chinese CPA Profession and to Enhance the Institution's Organizational Construction. July 2000.
should re-evaluate its training needs. Foreign secondments provide benefits to both individuals and to the CNAO. In particular, the availability of foreign-training opportunities will enhance the attractiveness of the CNAO to potential employees.

It is recommended that the CNAO develop an explicit strategy for professional development. Such a strategy might include:

- an analysis of current staff competencies against current and future requirements,
- an analysis of how well the core training program and other initiatives, such as continuing professional development, are meeting current and future needs,
- an assessment of the available options for addressing gaps in professional development, including the resources necessary for each option, and
- an integrated time-bound plan that included current professional development initiatives and new professional development initiatives.

9. CNAO: Computerized Audit Support Systems

The CNAO has been investigating the usage of computerized audit support systems, for instance, software that supports risk analyses, audit planning, working paper preparation, and computer assisted audit techniques (CAATs). However, the CNAO faces financial resource constraints in terms of procuring the necessary hardware and software and undertaking training.

Automated auditing systems offer considerable advantages in terms of audit effectiveness and efficiency. Moreover, they provide frontline auditors with ready access to reference materials such as audit standards. Most CPA firms, and many SAIs in developed countries, use these systems.

It is recommended that the CNAO collate the results of its research into computerized audit support systems and prepare a business case that includes an assessment of hardware, software and training requirements for consideration by the Government and other parties. The case should reflect the results of studies undertaken through ADB TA 3103-PRC.
10. China Institute of Internal Auditing: Standards

The Audit Law and the Accounting Law identify guiding principles, as well as the rights and responsibilities for internal auditors, but no detailed standards are provided which specify qualifications, competency, or the necessary due diligence processes and procedures that are required from internal auditors. Training and education needs cannot be adequately determined without clear standards. While the Professional Standards developed by the International Internal Auditing (IIA) Association were translated into Chinese in 1994, the document is treated as a reference and learning vehicle.

The development of professional standards that reflected the working environment in the PRC would be a major milestone in the development of the CIIA as a professional organization.

It is recommended that the CIIA should develop:

• a set of professional standards and guidelines and training materials to support their introduction, and
• Internal Auditing Standards, based upon International Internal Auditing Standards.

11. Training for Accounting Lecturers and Professors

In order to develop competent accounting graduates, the trainers themselves must be thoroughly conversant with modern-day practises and trends. The quality of undergraduate teachers is a key factor in developing competent accountants (Figure 6 refers).

Figure 6. Developing Competent Accountants

A rudimentary estimate, based on an average of 10 teaching staff at each of the 500 institutions teaching undergraduate accounting, is that the PRC has about 5,000 accounting teachers (higher education). However, the training target group for the National Accounting Institute does not include accountancy professors and lecturers.
It is recommended that:

- A specific training program for accounting professors and lecturers be developed and implemented; and
- A professional organization be established in order that accounting professors and lecturers may further their education and share their technical knowledge through a common forum.
- Accounting professors and lecturers be included in the targeted training group for the National Accounting Institute.

12. Development of Public Sector Accounting Standards

There are currently no firm plans for government organizations to report in accordance with the recently issued International Public Sector Accounting Standards (IPSASs). The Accounting Reform Project does however include a component for a research study into the feasibility of developing accounting standards for government and not-for-profit organizations (chapter VII refers).

It is recommended that, if the accounting reform project research supports the development of accounting standards for government and not-for-profit organizations:

- a project to implement public sector standards be developed, and
- a project to train government accountants in public sector standards be developed and implemented.

Part Two. Where External Assistance is Not Required

13. Conflicts between Standards and Regulations

Introduction

In 1992, the Ministry of Finance published the revised uniform accounting systems. The coexistence of the new accounting standards with the revised uniform accounting systems was justified because: substantial retraining was required for practitioners; large government bodies, which relied on accounting information from the uniform accounting systems to regulate different economic sectors, still existed; and national statistical reporting was reliant on accounting information from the uniform chart of accounts and uniform format of financial statements.
In 2000, most of the changes have already been taken up or are covered by other laws and regulations – for instance, the Accounting Standard for Business Enterprises, the Tax Law, and the Company Law. Furthermore, although the uniform accounting system emphasizes flexibility, it contains many detailed requirements; for instance, various ratios are prescribed (bad debts expenses, and entertainment expenses). The approach of issuing a revision of the uniform accounting systems was sound as a transitional measure. However, the full adoption of the new accounting standards, and the withdrawal of the uniform accounting system should remain the ultimate goal.

The coexistence of accounting standards and the uniform accounting system regulations frequently confuses accountants and auditors. On one hand the accounting standards require principles to be followed (for instance, that of prudence). On the other hand, the uniform accounting system regulations are extremely prescriptive.

There are distinct differences between financial reporting for listed companies and the reporting basis for non-listed companies (including SOEs).

Listed Company Reporting

A greater number of the new Accounting Standards apply to reporting by listed companies than to non-listed companies (chapter 1 refers). Even so, the application of statutory reporting requirements (uniform accounting system regulations) can yield quite different results than would international accounting standards – Table 10 on page 69 presents an example where, a company’s statutory accounts disclosed earnings-per-share of Y 0.13 but, when the accounts were adjusted to the full IAS basis, earnings-per-share were only Y 0.01.

Non-Listed Company Reporting

Nonlisted companies include most financial institutions (only two small-medium-sized banks are listed) and SOEs. The accounting regulations that apply to these organizations stipulate doubtful-debt provisions, loan provisions, etc. Consider two companies that are the same, and which began operations this financial year, except that:

- Good Collector’s stringent credit-approval procedures mean that only 2 percent of its receivables are not likely to be collected.
- Bad Collector’s lax debt-collection procedures mean that as much as 20 percent of its receivables are not likely to be collected.
Table 14 presents a simplified example which compares the results of these two companies where internationally-accepted accounting practices had been applied.

Table 14: International Practice

<table>
<thead>
<tr>
<th>Y ‘000</th>
<th>Good Collector Co. Ltd.</th>
<th>Bad Collector Co. Ltd.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Balance Sheet</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gross receivables</td>
<td>50,000</td>
<td>50,000</td>
</tr>
<tr>
<td>Less: Provision for</td>
<td></td>
<td></td>
</tr>
<tr>
<td>doubtful debts</td>
<td>(1,000)</td>
<td>(10,000)</td>
</tr>
<tr>
<td>Net receivables</td>
<td>49,000</td>
<td>40,000</td>
</tr>
<tr>
<td><strong>Income Statement</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Revenues</td>
<td>100,000</td>
<td>100,000</td>
</tr>
<tr>
<td>Expenses</td>
<td></td>
<td></td>
</tr>
<tr>
<td>General</td>
<td>80,000</td>
<td>80,000</td>
</tr>
<tr>
<td>Doubtful debts expense</td>
<td>1,000</td>
<td>10,000</td>
</tr>
<tr>
<td></td>
<td>81,000</td>
<td>90,000</td>
</tr>
<tr>
<td>Profits before taxation, etc</td>
<td>19,000</td>
<td>10,000</td>
</tr>
</tbody>
</table>

Compare these results with those in Table 15 that presents an example where PRC statutory reporting requirements have been applied (for the purpose of the example, it is assumed that the mandated provision level for doubtful debts is set at 2 percent).

Table 15: Mandated Provisioning Levels set at Two Percent

<table>
<thead>
<tr>
<th>Y ‘000</th>
<th>Good Collector Co. Ltd.</th>
<th>Bad Collector Co. Ltd.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Balance Sheet</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gross receivables</td>
<td>50,000</td>
<td>50,000</td>
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<tr>
<td>Less: Provision for</td>
<td></td>
<td></td>
</tr>
<tr>
<td>doubtful debts</td>
<td>(1,000)</td>
<td>(1,000)</td>
</tr>
<tr>
<td>Net receivables</td>
<td>49,000</td>
<td>49,000</td>
</tr>
<tr>
<td><strong>Income Statement</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Revenues</td>
<td>100,000</td>
<td>100,000</td>
</tr>
<tr>
<td>Expenses</td>
<td></td>
<td></td>
</tr>
<tr>
<td>General</td>
<td>80,000</td>
<td>80,000</td>
</tr>
<tr>
<td>Doubtful debts expense</td>
<td>1,000</td>
<td>1,000</td>
</tr>
<tr>
<td></td>
<td>81,000</td>
<td>81,000</td>
</tr>
<tr>
<td>Profits before taxation, etc</td>
<td>19,000</td>
<td>19,000</td>
</tr>
</tbody>
</table>
While these regulations may improve official statistics and enhance tax collections, they are not in line with internationally accepted accounting practices.

It is recommended that laws and regulations be amended as necessary so that, where a conflict arises between regulations and the Accounting Standards, the Accounting Standard treatment overrides the regulated treatment.

14. CPA and CICPA Independence

The most important element among the fundamental ethical principles accepted by the international accounting profession is independence. As a regulatory organization for CPAs, the status, authority, and independence of CICPA directly influence the independence of Chinese CPAs. However, most CICPA officials are Ministry of Finance employees and the organization works under the direct supervision of the Ministry of Finance. As such, CICPA is more a government organization than a professional body. However, in late July 2000, the Ministry of Finance tentatively agreed that CICPA could be de-linked and re-established as an independent, professional organization. This will require amendments to the CPA Law 1993.

It is recommended that de-linking of the CICPA from the MOF be pursued as a priority.

15. Accounting Standard-Setting Body

The issue of whether accounting standard-setting should be a government or private-sector function is a common one for many countries. This was certainly the case in the PRC, which took the former option. The assignment of this role is influenced by country-specific factors including: the role that the Central Government plays in the economy; the status of the legal system – in European countries, where the status of the legal system is considered to be of the utmost importance (e.g., Germany and France), financial reporting requirements are codified in laws; and the influence of historical factors – for instance, accounting standards in Anglo-Saxon countries were traditionally

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developed by professional organizations, such as the Financial Accounting Standards Board (FASB) in the US, and the Accounting Standards Committee in the U.K.\textsuperscript{92}

In the PRC, most observers agreed that accounting standard-setting should be a government function on the basis that only the Government, has the required authority to enforce the implementation and monitoring of accounting standards. This report concurs with the decision to initially assign standard-setting responsibilities to the Ministry of Finance, for two reasons. First, the Ministry of Finance had the necessary authority to enforce the implementation and monitoring of accounting standards. Second, the profession arguably lacked the necessary depth to support a self-regulating regime. Furthermore, the personnel in the relevant departments of the Ministry of Finance had a strong comparative advantage in standard setting and were respected by the accounting profession and by finance institutions.

At this point, these arrangements should be seriously reconsidered – particularly in light the conflicts between accounting standards and accounting regulations (see above).

It is recommended that the Ministry of Finance consider assigning accounting standard-setting responsibilities to an independent body that is comprised of financial sector representatives, financial sector regulators, and representatives from the accountancy profession.

16. The Availability of Professionally Competent CPAs\textsuperscript{93}

An increased demand for accounting services, and for the professionals able to provide those services, was a natural consequence of the economic reforms. The following issues have been identified in this respect.


ISSUES AND RECOMMENDATIONS

Box 5: Availability of Certified Public Accountants in 1992

According to a report prepared by the Ministry of Finance in 1992; due to the shortage of CPAs, only 30 percent of foreign-invested enterprises, 20 percent of domestic joint ventures, and 15 percent of group companies, were audited by CPAs even though their financial statements were required to be audited by independent auditors.94

First, the CPA certification process hindered professional quality improvements. Before the introduction of the Uniform CPA Examination, subjective entry criteria prevailed. Consequently, there was a wide variation in the quality of CPAs. This was exacerbated by other factors, such as the ageing of CPAs, the lack of emphasis on continuing professional education, and a general lack of understanding of modern business practices.

Second, historical factors - mainly the hiatus associated with the Cultural Revolution, combined with the educational changes that accompanied the economic reforms - created significant age-related differences among CPAs. According to a MOF survey, 78 percent of CPAs were over 60 years old in 1992. In contrast, large numbers of young university graduates joined the profession after the unified CPA examination was introduced in 1991. The first group had experience but lacked a modern accounting education. Furthermore, they were getting too old to be in management positions. Conversely, the young CPAs were technically qualified but lacked the experience to hold senior positions. This situation has an upside. The development of the accountancy profession in former Soviet Union countries, which face similar transition problems to the PRC in terms of developing a market-oriented accounting profession, is hindered by the reticence of senior members to adopt new practices. In contrast, the significant demographic discontinuity in the PRC’s accountancy profession means that this issue will largely resolve itself in the next five to 10 years.

Third, increasingly complex business transactions have accompanied the PRC’s rapid economic development. The professional knowledge and competence of the PRC’s CPAs should keep up with these changes through developments to the CPA examination syllabus and to CPE. This is not the case. Some CPAs in smaller firms do not understand newly promulgated accounting standards, such as cash flow

statements. This makes it difficult for CPAs to exercise accurate professional judgment, which may result in audit failures. Many of the malpractice suits filed against CPA firms in recent years are related to this. Fourth, the shortage of CPAs in some remote inland areas is particularly serious.

Professionally competent CPAs are the product of years of specialized education, on-the-job training, and practical experience. There are two options available to quickly increase the number of CPAs: import CPA skills, and/or lower professional admission criteria. By opening up entry to the domestic accounting market, the PRC has implicitly decided to import CPA skills. It has prudently opted not to pursue the latter option.

The increased demand has made accountancy a career choice for many young Chinese. The CICPA estimates that around 10 percent of tertiary students are opting for accountancy majors. In combination with high entry standards (employment screening and the Uniform Accounting Examination), this means that the profession is employing many of the best and brightest graduates. The professional environment that these graduates are entering is conducive to rapid skills development because of professional development initiatives, e.g., the establishment of the National Accounting Institute, and external factors, e.g., CPA firms have introduced structured professional development and on-the-job training programs because of litigation threats and improved professional supervision.

In summary, the availability of professionally competent CPAs will be a natural consequence of the mixed-market economy. Support can be provided through the continuation of existing initiatives on training and supervision.

17. CPA Legal Liabilities

While the exposure of the accountancy profession to legal litigation has had a beneficial effect on professional ethics and audit quality, the current legal situation does not accord with legal principles of equity, fairness, and certainty. In response to the legal contradictions, CICPA has taken, or is taking, the following measures:

- In March 1998, CICPA organized a conference to examine CPAs’ legal liabilities. The conference not only helped CICPA summarize the situation, but also helped legal participants gain a better understanding of the complexity of the area.
• On 22 July 1999, the Ministry of Finance issued Financial Coordination No. 102 (1999), which further clarifies the role of capital-verification reports. In particular, the document says that the reports can only provide a reasonable guarantee, rather than an absolute one, because of the inherent limitations of capital verification.
• CICPA, with MOF support, is currently working on a revision of the CPA Law 1993 to address the weak points of existing laws and regulations.
• The MOF and CICPA are coordinating with legal officers from the Supreme Court.

Addressing the issues surrounding CPA legal liabilities in the PRC is a complicated and difficult task. Other countries also struggle with this issue, for instance, the United States Congress limited CPA liability with the approval of the Private Securities Litigation Reform Act in 1995. The revision of the CPA Law and associated regulations will be a major step forward. Further steps require realignment of fundamental laws including the Criminal Law and the Civil Law.

18. CPA Professional Ethics\(^{95}\)

Business ethics were not a serious problem in the environment of the planned economy. They are in the new mixed-market economy. The Rectification Campaign identified hundreds of examples of ethical violations. These violations involved the preparation of falsified financial statements, and the inflation of asset values (for instance).

CICPA has made tremendous efforts to improve professional ethics. Specific initiatives include: developing and promulgating ethical standards and guidelines, strengthening practice supervision, highlighting ethical breaches in the media, and introducing professional ethics into the tertiary curriculum, into the curriculum for the CPA uniform examination, and as a Continuing Professional Education (CPE) topic. In addition, the revised Accounting Law has strengthened the penalties for breaches. These now range from Y2,000 to Y100,000.

Professional ethics have been the focus of considerable debate in international academic and professional circles for the past 20 years. The debate centers on the effectiveness, or otherwise, of teaching professional ethics. This report’s view is that a set of professional and

---

ethical standards and guidelines is useful. However, these standards should be clear and practical. The guidelines should provide real-life examples to illustrate the differences between acceptable practices and unacceptable practices. Moreover, ethics should be taught by way of practical case studies, not by lectures on philosophy. CICPA’s standards, guidelines, and training practices meet these criteria. This report considers that CICPA’s multi-pronged approach on this issue is appropriate.

19. Structure and Contents of Accounting Standards

General Versus Specific Accounting Standards

Under the old uniform accounting system, very detailed instructions governed accounting and reporting practices. These instructions (regulations and procedural guidelines) differed based on entity size, ownership, and industrial characteristics. There was controversy as to whether the same set of accounting standards could be applied to all business enterprises regardless of their special characteristics. One group argued that industry- and ownership-specific accounting standards should be developed. Another group argued that this approach would not be cost effective and would conflict with the overall objective of replacing the existing uniform accounting system with accounting standards. The PRC decided to adopt a two-pronged approach to this issue. First, general accounting standards are being developed (e.g. the Basic Accounting Standard). Second, sector-specific accounting standards will be developed. For instance for the banking sector, and for the oil and gas sector.

This report concurs with this approach, on the basis that it has successfully reconciled the divergent views, and is consistent with international practice. For instance, the proposed standard for the banking sector will be based on IAS 30.

Conceptual Versus Procedural Content

In the early stages of accounting-standard development in the PRC, one group held that standards should only consist of fundamental accounting principles and concepts like reliability, consistency, and materiality because these principles and concepts form the basis on which accounting information is prepared. Another group recommended that accounting standards should be defined as detailed and authoritative, rules that accountants should comply with in
financial reporting. These views have been reconciled in the China Accounting Standards. The Basic Accounting Standard sets out concepts and principles, for instance: “Assets are economic resources, which are measurable by money value, and which are owned or controlled by an enterprise, including all property, rights as a creditor to others, and other rights (Article 22).” Individual accounting standards provide detailed rules. For instance, Article 27 of the Investment Standard states that, “An enterprise should disclose the following items relating to investments in the financial statements: significant restrictions on the realisability of investments or the remittance of investment revenue. Appended materials (such as report formats) and supplementary guidance materials are published with accounting standards.

This report concurs with the approach taken, on the basis that it has successfully reconciled the divergent views, and is consistent with the approach taken by other jurisdictions. For instance, US Generally Accepted Accounting Practices is comprised of Financial Accounting Standards Board’s Statement of Financial Accounting Concepts (SFAC) and Statements of Financial Accounting Standards (SFAS).
IX. Main Deficiencies and Action Plan

The People’s Republic of China has made remarkable progress in reforming accounting and auditing arrangements to meet the needs of a mixed-market economy. Given the sheer size of this task, it is not surprising that this study has identified gaps and weaknesses, which may be categorized as follows:

- Those deficiencies that are better able to be resolved with external assistance.
- Those deficiencies that are able to be resolved without the need for external assistance.

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<tr>
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<tbody>
<tr>
<td>Assisting CICPA with a project to improve professional supervision</td>
<td>High</td>
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<td>Assisting CICPA to reform the CPA examination system</td>
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<td>✔</td>
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<tr>
<td>Assisting the MOF to reform the National Uniform Accountant examination system</td>
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<td>Assisting the CNAO to develop an explicit strategy for professional development</td>
<td>High</td>
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<td>Assisting the CNAO to identify, procure, and implement computerized audit support systems</td>
<td>High</td>
<td>✔</td>
<td>✔</td>
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<tr>
<td>Assisting the CIIA to develop a set of professional standards and guidelines and training materials to support their introduction</td>
<td>High</td>
<td>✔</td>
<td>✔</td>
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<tr>
<td>Assisting in the development and implementation of a training program for accounting professors and lecturers be developed and implemented</td>
<td>High</td>
<td>✓</td>
<td>✓</td>
<td></td>
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<td>Conflicts between Regulations and Accounting Standards</td>
<td>High</td>
<td>×</td>
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<td>Assisting the establishment of a professional organization to represent accountants (Non-CPAs)</td>
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<td>✓</td>
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<td>Assisting the Chinese Institute of Internal Auditing (CIIA) to develop internal auditor examination systems and certification procedures</td>
<td>Medium</td>
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<tr>
<td>Assisting CICPA to improve training materials for CPA continuing professional education</td>
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<tr>
<td>Assisting the CIIA to develop a set of Internal Auditing Standards, based upon International Internal Auditing Standards</td>
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<tr>
<td>Assisting in the development and implementation of public sector standards</td>
<td>Medium</td>
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<td></td>
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<tr>
<td>The lack of independence of the accountancy profession (CICPA) from the Government</td>
<td>Medium</td>
<td>×</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>The lack of independence of accounting standard-setting responsibilities from the Government</td>
<td>Medium</td>
<td>×</td>
<td>✓</td>
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Appendix 1. Interviewees

Aspects of financial management and governance were discussed with the following people.

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<thead>
<tr>
<th>Interviewee</th>
<th>Position</th>
<th>Organization/Institution</th>
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<tbody>
<tr>
<td>Honorable Li Yong</td>
<td>Assistant Minister of Finance</td>
<td>Government of the People's Republic of China</td>
</tr>
<tr>
<td>Bruce Murray</td>
<td>Director</td>
<td>Asian Development Bank, PRC Resident Mission</td>
</tr>
<tr>
<td>Min Tang</td>
<td>Senior Economist</td>
<td>Asian Development Bank, PRC Resident Mission</td>
</tr>
<tr>
<td>Henri-Paul Normandin</td>
<td>Head</td>
<td>Canadian International Development Agency (CIDA), Development Section</td>
</tr>
<tr>
<td>Shen Xianonan (Sharon)</td>
<td>Vice Secretary-General</td>
<td>China Accounting Standards Committee</td>
</tr>
<tr>
<td>Lu Jianqiao</td>
<td>Officer</td>
<td>China Accounting Standards Committee</td>
</tr>
<tr>
<td>Shelly Warner</td>
<td>Program Manager</td>
<td>China-Australia Capacity Building Program (AUSAid)</td>
</tr>
<tr>
<td>Li Shuang</td>
<td>Vice Secretary-General</td>
<td>Chinese Institute of Certified Public Accountants (Former Deputy Secretary-General of the Chinese Institute of Internal Auditing).</td>
</tr>
<tr>
<td>Jie Li</td>
<td>Director</td>
<td>Chinese Institute of Certified Public Accountants, Comprehensive Department</td>
</tr>
<tr>
<td>Chuck H. X. Zhang</td>
<td>Head</td>
<td>Chinese Institute of Certified Public Accountants, International Department</td>
</tr>
<tr>
<td>Flora Wu</td>
<td>Officer</td>
<td>Chinese Institute of Certified Public Accountants, International Department</td>
</tr>
<tr>
<td>Wu Hua</td>
<td>Officer</td>
<td>Chinese Institute of Certified Public Accountants, International Department</td>
</tr>
<tr>
<td>Name</td>
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<tr>
<td>Luo Mei</td>
<td>Deputy Director</td>
<td>Chinese Institute of Certified Public Accountants, Professional Standards Department</td>
</tr>
<tr>
<td>Yang Zhiguo</td>
<td>Director</td>
<td>Chinese Institute of Certified Public Accountants, Standards Department</td>
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<tr>
<td>Denis Grubb</td>
<td>Senior Manager</td>
<td>Deloitte Touche Tohmatsu</td>
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<tr>
<td>Arthur Wong</td>
<td>Partner, Deputy General Manager</td>
<td>Deloitte Touche Tohmatsu</td>
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<tr>
<td>Jung Yi Qing</td>
<td>Partner</td>
<td>Deloitte Touche Tohmatsu, Assurance and Advisory Services</td>
</tr>
<tr>
<td>Qun Wu</td>
<td>Senior Manager</td>
<td>Deloitte Touche Tohmatsu, China Accounting Reform Project</td>
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<td>Ya Lin Wu</td>
<td>Senior Manager</td>
<td>Deloitte Touche Tohmatsu, Financial Management / CNAO Performance Auditing Project</td>
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<tr>
<td>John Shecan</td>
<td>Project Coordinator</td>
<td>German Technical Cooperation Organization (GTZ)</td>
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<tr>
<td>Paul Heytens</td>
<td>Resident Representative</td>
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<td>Davie Yau</td>
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<td>Chen Shixin</td>
<td>Officer</td>
<td>Ministry of Finance, Budget Division, Regulation Department</td>
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<td>Wang Ying</td>
<td>Officer</td>
<td>Ministry of Finance, Technical Assistance and Human Resources Development Division</td>
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<tr>
<td>Zhang Wencai</td>
<td>Deputy Director</td>
<td>Ministry of Finance, Technical Assistance and Human Resources Development Division</td>
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<tr>
<td>Zhang Nianshan</td>
<td>Officer</td>
<td>Ministry of Finance, Technical Assistance and Human Resources Development Division</td>
</tr>
<tr>
<td>Xinhua Xue</td>
<td>Director</td>
<td>National Audit Office, Foreign Funds Application Department</td>
</tr>
<tr>
<td>Yang Xuejun</td>
<td>Officer</td>
<td>National Audit Office, Foreign Funds Application Department</td>
</tr>
<tr>
<td>Kent Watson</td>
<td>Chairman</td>
<td>PriceWaterhouseCoopers</td>
</tr>
<tr>
<td>Yannick Glemarec</td>
<td>Deputy Resident Representative</td>
<td>United Nations Development Program</td>
</tr>
<tr>
<td>Yuexin Du</td>
<td>Manager</td>
<td>United Nations Development Program, Economics and Governance Cluster</td>
</tr>
<tr>
<td>Shen Chau-Ching</td>
<td>Senior Financial Management Specialist</td>
<td>World Bank Resident Mission</td>
</tr>
</tbody>
</table>
Appendix 2. RETA-5877 (Regional Study) Information

1. **Study Phases**

The study had four broad phases as follows:

Phase I – PRC Case Study on Available Accounting and Auditing Support and Structures

Phase II – Beijing Workshop (14 August 2000)

Phase III – Development of Reference Materials

Phase IV – Formulation of Action Plan

2. **Phase I: Country Case Study**

This phase involved the examination of the PRC’s current accounting and auditing structure and systems. It also (i) analyzed the PRC’s political, institutional, and regulatory and legal framework on accounting and auditing practice and the level of enforcement of existing laws, rules, and regulations; (ii) identified gaps and weaknesses in accounting and auditing support available and deviations from international standards; and (iii) identified alternative options to remedy the identified weaknesses, with the objective of eventually doing away with these.

A structured questionnaire, that covered the following areas, was used to collect descriptive information:

(i) Legal and regulatory framework (public and private sector)
(ii) Accounting infrastructure (professional bodies and accounting standards)
(iii) Institutional issues (public and private sector)
(iv) Government and administrative arrangements
(v) Financial reporting (public and private sector)
(vi) Accounting and computerization (public and private sector)
(vii) Accountancy education and training
(viii) Budgeting (public sector)
(ix) External audit (public and private sector)
(x) Previous studies and initiatives on financial management and governance.

Barry Reid conducted the fieldwork for the study with the able assistance of Zhang Ran, from 14 July to 11 August 2000. Financial management and governance arrangements were discussed with representatives from: the Ministry of Finance, other government organizations, professional accounting and auditing bodies, private-
sector businesses, bilateral donors, and multilateral financing institutions. A list of interviewees is attached as Appendix 1. A range of materials and reports were reviewed.

3. **Phase II: Beijing Workshop**

Issues arising from the study were discussed and debated at a workshop held in Beijing on 14 August 2000. Zhang Nianshan of the Ministry of Finance and Barry Reid jointly chaired the Workshop. Francis B. Narayan, Lead Financial Specialist, ADB, participated in the Workshop as a resource person and provided overall guidance with respect to the objectives of the Study. Twenty-five participants, representing the following organizations, attended the workshop:

- China Accounting Standards Committee
- Chinese Institute of Certified Public Accountants
- Deloitte Touche Tohmatsu
- National Accounting Institute
- Ministry of Finance
- China National Audit Office
- United Nations Development Program (UNDP)
- ADB Resident Mission

4. **Phase III: Development of Reference Materials**

In Phase III, reference materials on International Accounting and Auditing Standards (IAAS) were developed. In developing these materials, consideration was given to production of these materials in local languages.

5. **Phase IV: Formulation of Action Plan**

Phase IV assessed the roles that ADB and other funding agencies played in improving the current situation in the selected DMCs. The roles included policy intervention, projects and program assistance, and mobilization of cofinancing resources to address the identified problems and weaknesses. This activity was undertaken in close consultation with the Government, regulatory authorities, representatives of the accounting and auditing professions, and other local interest groups and funding agencies. At this stage of the RETA, the commitment in principle of each selected country to implement the findings and recommendations of the study was agreed. The findings of the RETA were disseminated and debated at a conference in Manila from 16-18
October 2000 and the developed action plan was finalized for implementation.

6. Consultation

Drafts of this report were provided to a variety of organizations and individuals for review. We would like to thank the following people for their helpful comments:

- Bruce Murray, Director, Asian Development Bank, PRC Resident Mission
- Shen Xianonan, Vice Secretary-General, China Accounting Standards Committee
- Shelly Warner, Program Manager, China-Australia Capacity Building Program (AusAID)
- Madeleine Varkay, Asian Development Bank
Appendix 3. Administrative and Institutional Arrangements

1. Introduction

This appendix describes administrative and institutional arrangements in the People's Republic of China. The appendix begins with a description of executive, legislative and judicial arrangements. The role of the key organs of state authority in relation to financial management are then reviewed followed by a description of the financial sector, securities markets, and the State-owned enterprise sector.

2. Legislative, Executive and Judicial Arrangements

Legislative Branch

The unicameral National People's Congress (NPC) is the legislative branch of the Chinese government and has 2,979 seats. Members are elected to the NPC by municipal, regional, and provincial People's Congresses to serve five-year terms. As the NPC meets only once each year, its legislative powers are largely delegated to the Standing Committee of the NPC.

The President and the Vice-President are elected by the NPC for terms of five years. The President has the power to promulgate statutes, appoint or remove the Premier and other members of the State Council, and ratify or abrogate treaties with foreign states. The Vice-President assists the work of the President.

Executive Branch

The State Council is the highest state administrative organ. It enforces the laws and decisions formulated and approved by the NPC and the Standing Committee of the NPC, to which it is responsible and accountable. It has the power to promulgate administrative measures and regulations, and to issue orders.

The Premier has overall responsibility for the State Council's work and can convene and preside over executive and plenary meetings. Executive meetings are comprised of the Premier, Vice-Premiers, State Councilors and the Secretary-General. Plenary meetings are comprised of the Premier, Vice-Premiers, State Councilors, the Secretary-General, ministers in charge of ministries and commissions, and the Auditor General. Major decisions must be discussed and approved either at executive meetings or plenary meetings of the State Council. The State
Council controls the activities of ministries, commissions, and the different levels of local government.

Judicial Branch
The Judicial Branch comprises central, provincial, municipal, and local courts with the Supreme People's Court at the top. Judges are appointed by the NPC.

3. Key State Organizations
The key state organizations that have responsibility for financial management arrangements are the: Ministry of Finance (MOF), China Securities Regulatory Commission (CSRC), Chinese Institute of Certified Public Accountants (CICPA), China Accounting Standards Committee (CASC), and China National Audit Office (CNAO). The functions of the MOF and the CSRC are described below. The functions of the other three organizations are described in the body of the report.

Ministry of Finance
The Ministry of Finance is responsible for issues related to fiscal revenues and expenditures, fiscal policies, and the management of State-owned equity. Its specific responsibilities in respect of financial management arrangements are:

- drafting laws and regulations on the administration of public finance and State-owned equity,
- preparing, promulgating and implementing regulations governing fiscal, financial and accounting management,
- compiling the Central Government’s annual budget and preparing monitoring reports on budget implementation,
- formulating and implementing the Accounting Regulations for Government Agencies and the Accounting Regulations for Public Institutions,
- formulating and implementing the General Principles on Enterprise Accounting,
- formulating and implementing accounting regulations and the Principles for Enterprise Accounting,
- formulating and monitoring the implementation of the government’s overall budget and accounting regulations governing the government agencies, public institutions, and industries,
guiding and monitoring the business operations of Certified Public Accountants and CPA firms,
- guiding and regulating the auditing business, and
- reviewing and approving the establishment of representative offices and branches of foreign CPA firms.

China Securities Regulatory Commission (CSRC)
The CSRC which was established in 1992, and whose functions are similar to the US Securities Exchange Commission (SEC), has the following responsibilities in relation to financial management arrangements:
- supervising information disclosure and dissemination related to securities and futures, and
- certifying accounting firms (and their professional staff) engaged in securities and futures intermediary businesses, and supervising their activities.

In the past two years, the CSRC has actively issued regulations and instructions to improve the disclosure of financial information. In the last year, these regulations and instructions have been issued in accordance with the Securities Law 1999.

Other Institutions
The People's Bank of China (PBC) supervises the auditing of banks and other financial institutions, and the China Insurance Regulatory Commission (CIRC) regulates the provision of accounting information from Insurance companies.

4. The Financial Sector
The PRC’s current banking system dates from the 1948 establishment of the People's Bank of China (PBC). After the founding of the PRC in October 1949, PBC assumed all of the existing Chinese and foreign banks' functions. It also served as a central bank and government treasury, and directed and supervised all specialized subsidiary banks, nonbank financial institutions, and insurance companies. Three major specialized banks existed under PBC: the Agricultural Bank of China (ABC), serving the agricultural sector; the People's Construction Bank of China (CCB), specializing in infrastructure finance; and the Bank of China (BOC), which acted as the PRC’s foreign-exchange bank.
PBC held a monopoly on banking functions until 1979 when banking reforms received immediate attention. The first reforms began with the devolution of various banking functions from PBC to the three specialized State-owned banks.

The period following the promulgation of the Commercial Bank Law and the Central Bank Law in 1995 saw the development of other financial institutions to meet the increasingly complex and growing needs of a modernizing economy. One new type of banking institution was the share-ownership commercial bank, in which various levels of government, Chinese institutions, and in rare cases individuals, hold shares. Another new type of financial institution was the urban cooperative bank, which evolved out of the PRC’s 5,000-plus urban credit cooperatives. This ongoing restructuring process resulted in 88 new urban commercial banks and 3,240 urban credit cooperatives by the end of 1998. There are also still around 41,500 rural credit cooperatives, but these operations mainly serve individuals and small enterprises.

The reform of the PRC’s banking sector presents a substantial challenge. Despite recent reforms, the PRC’s State banks have suffered declining capital-asset ratios and incurred losses on loans to state enterprises. The PRC has learnt a great deal, however, from the Asian financial turmoil, and has been adopting reform measures aimed at strengthening the banking sector. The PBC is now pursuing a program to enhance bank supervision, introduce risk management techniques in state banks, reduce the accumulation of nonperforming loans, advocate routine use of international accounting standards and practices, raise loan-loss provisioning and launch a new loan classification system.

Nevertheless, while the PRC is continuing to announce and implement a steady stream of reform measures, the key underlying problems have not yet been identified, nor has a clear medium term strategy been developed. This task is enormously complicated given the size and the institutional complexity of the Chinese financial sector, the fiscal costs of repair, and the complexity of the political decision-making process. The PRC’s entry into WTO and the associated commitments to liberalize and open up the financial sector to foreign competition, combined with the recent re-endorsement of a private sector-dominated economy, will steadily increase the urgency of interest and exchange rate reforms and bank restructurings. In the opinion of the World Bank, the prospects of a banking crisis, while still very low, have not been eliminated, nor has the level of expected fiscal repair costs.

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reduced dramatically. With each additional reform measure, Chinese authorities are running out of easy options.97

5. Securities Markets

The PRC has developed a nationwide equity market with two stock exchanges located in Shanghai and Shenzhen. The stock exchanges have been continuously updating their technology, improving services, and consistently developing conditions that provide a foundation to expand the market. They have also been improving trading, settlement, and registration and custody practices, and upgrading the information transmission system.

The PRC’s securities market originally comprised a group of independent local exchanges. With the improvement of the securities market's regulatory system and operational mechanisms, these stock exchanges have developed into an integrated marketplace with nationwide coverage. Stock issues are subject to approval by the China Securities Regulatory Commission (CSRC). Article 11 of the Securities Law 1998 states that "a public stock issue shall follow the conditions stipulated in the Company Law and be submitted to the CSRC for verification." At the end of 1999, about 950 companies were listed on the Shanghai and Shenzhen stock exchanges, and the total market capitalization was ¥1,950 billion ($236 billion, 24.5 percent of GDP).

Major hurdles are faced in implementing a consistent package of reforms in the capital markets. First, just 950 companies have been listed on the stock market in the past decade, of which more than 900 are State-owned. The Government’s recent announcement of its intention to dilute its average holding in listed SOEs from 62 percent to 51 percent implies an issuance equal to an additional 25 percent of currently traded stocks.

Second, the listing of just a small portion of the 9,000 large, and 8,000 medium, SOEs would severely test the absorptive capacity of the stock exchanges, brokerages, and the CSRC (in terms of listing, trading, placement, and regulatory abilities). This limits the Government's capacity to simultaneously maximize divestment revenue, avoid a downturn in the market, and execute well-prepared, transparent divestment transactions.

Third, the bond market is affected by interest rate controls in the banking sector, remaining directed lending, restrictions on foreign

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financial institutions' Renminbi activities, and underdevelopment of institutional investors. Despite a substantial increase in issuances, an integrated, professional government-securities market does not exist.

Problems include the absence of a strategy for systematic benchmark issuance and maintenance of the yield curve, multiple issuance methods aimed at exploiting segmented and differentiated prices, inadequate development and standardization of issuance process and market makers, and coordination between Ministry of Finance, People's Bank of China and other quasi-sovereign issuers. Corporate bond markets and markets for asset-backed securities are virtually absent. Development of institutional investors, which are needed to intermediate the PRC's vast retail pool of savings, and to help its large population obtain adequate financial services, are missing for a variety of reasons. Pension funds are essentially nonexistent and will remain so without a major reform that simultaneously addresses SOE restructuring, the funding of accrued pension rights, the and swapping of State-owned assets and housing to fund/discharge accrued pension liabilities. Finally, the average Chinese household holds substantial and rapidly increasing, financial assets estimated at around Y53,000 ($6,400), and 84 percent of these assets continue to be invested in savings accounts or held in cash, while only 12 percent is invested in securities.\(^8\)

6. State-Owned Enterprise Sector

The PRC’s 300,000 SOEs are burdened by huge amounts of bad loans remaining from the planned-economy era. SOEs are an expensive burden for the government, and hamper both job creation and economic growth. The country is in the midst of a program to merge, close or sell redundant SOEs while making larger ones in key sectors more competitive.

The PRC’s SOE reform strategy is to concentrate resources on improving the performance of the large SOEs considered strategic for national development, while letting go of the very large number of smaller enterprises, many of which are simply not viable. Pilot programs that involved divestiture, bankruptcy, mergers, governance, and ownership reform are now being mainstreamed. The Government has funded a major investment program to encourage labor market expansion in order to absorb displaced urban workers.

A wave of reforms linked to a modern enterprise system, including pension reform, other forms of social protection including support for newly unemployed workers (income supplements and retraining programs) and social welfare for the indigent poor. Housing reform and health care financing are the most recent major government initiatives.

After an extraordinarily bad year in 1998, the profitability of SOEs improved markedly in 1999. For instance, a combination of domestic restructuring and sustained global demand saw the textile industry, which had suffered six consecutive years of losses, posting an estimated profit of Y800 million ($96.7 million). The textile industry was not alone, profits also grew significantly in the petrochemical industry, with profits rising nearly 200 percent year-on-year to an estimated Y30 billion ($3.6 billion), in large part due to the anti-smuggling campaign, which began in 1998.
Appendix 4. Regulatory and Legal Framework

1. Introduction

Since 1993, the PRC has formulated many market-related laws and is working to establish a legal system that is responsive to the needs of a market economy. This is a major task but significant progress has been made. An important step achieved in 1999 was enshrining the rule of law in the Constitution. In addition, the Government has adopted a five-year legislative work program covering the period from 1999 to 2003. During this period the Government plans to amend a number of existing economic laws, prepare a new set of laws, as well as draft implementing regulations for other laws. One example is the Accounting Law 1985 that was revised in 1999 to improve the basic systems and regulations affecting accounting, strengthen the control of accounting practices, and punish those who violate the law.

Other major milestones in improving the PRC’s legal framework in the past 18 months included; (i) making the Securities Law effective, (ii) enacting the Contract Law, (iii) adopting the law on Individually-owned Enterprises to clarify and simplify the rules for establishing individually-owned businesses and providing these private businesses with the protection of the law, and (iv) adopting a new law dealing with illegal financial practices which covered banks, credit cooperatives, finance companies, trust and investment companies, and leasing companies. Business risks, particularly those related to listed companies and foreign investment, can now be assessed more rationally, transaction costs have been lowered and arbitrary government actions have been reduced, although not totally eliminated. To complement the passage of the new laws, massive human resource development programs are planned to train the judges, lawyers, and others involved in administering, interpreting, and enforcing the new legal system.

The key laws that will be covered under this five-year program include company law, bankruptcy law, trust law, anti-monopoly law and unfair competition law, telecommunications law, trademark and patents law, income and inheritance tax law, government procurement law, and state assets law.

2. Overview of Legal and Regulatory Framework

In common with other countries that are transiting to a mixed-market economy, the PRC inherited its legal framework from the former Soviet Union. With the introduction of the economic reforms, the PRC began developing its present legal system in the late 1970s. The legal framework includes laws, regulations, rules, and some official decisions.

The Constitution is the PRC’s supreme source of law. The Constitution now in force was enacted in 1982 and was revised in 1988 and 1993. The second level of law is comprised of basic statutes enacted by the National People's Congress (NPC). The third level of law is comprised of statues enacted by the Standing Committee of the NPC. Administrative laws are the fourth level of law. Article 89 of the Constitution provides the State Council with the power to; adopt administrative measures, enact administrative rules, and to issue regulations, decisions, and orders in accordance with the Constitution and the statutes. These include: laws made under powers granted by the NPC, administrative regulations made by the State Council, and administrative rules made by ministries and commissions of the State Council. Local laws are the fifth and final level of law and include local regulations, local statutes and administrative rules and regulations. Laws made at various levels and by various bodies often conflict. While the avalanche of new laws and regulations in the past 15 years, combined with fundamental system changes exacerbated the situation with respect to conflicts, the five-year legislative program will address many of the root causes of these conflicts.

3. Financial Management Laws and Regulations

This section provides information on the key laws and regulations that govern financial management arrangements in the PRC. These are grouped into two levels; statutes (including basic statutes), and administrative laws.

Statutes (second and third levels)

The key statutes (i.e. laws approved by the NPC) in relation to financial management arrangements are as follows:
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<tr>
<td>Accounting Law 1985</td>
<td>This law applies to public and private sector accounting. The latest revision took effect on 1 July 2000, and covers general accounting principles, accounting rules, corporate-accounting rules, supervision of accountants, accounting firms and accountants, and their legal responsibilities. The most recent amendments are intended to improve the basic systems and regulations affecting accounting, strengthen the control of accounting practices and punish those who violate the law. The Accounting Law was last amended in 1993, when its scope was broadened from State-owned enterprises to all registered enterprises.</td>
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<tr>
<td>Audit Law 1994</td>
<td>This law was promulgated to strengthen state supervision through auditing, maintain the economic and financial order, promote the development of clean government, and ensure the healthy development of the national economy. It defines the basic principles for government auditing supervision, government audit institutions and auditors, the responsibilities and powers of audit institutions, audit procedures, and the legal liability of auditors.</td>
</tr>
<tr>
<td>Certified Public Accountants Law 1993</td>
<td>The implementation of this law on 1 January 1994 was a significant milestone for the PRC’s CPA profession. It lays down clear rules and regulations for the profession's administration system and organizational structure. Particular issues covered include CPA examination and membership requirements, the structure of the CPA Institute, and legal responsibilities and disciplinary procedures. The Law is currently being reviewed with the intention of issuing a revised version. The two key issues being addressed are; de-linking the CPA Institute from the Ministry of Finance, and clarifying CPA liabilities.</td>
</tr>
<tr>
<td>Companies Law 1993</td>
<td>Chapter 6 of this law briefly sets out the requirement that limited-liability companies must prepare annual financial statements that include a balance sheet, a cash flow statement and an income statement.</td>
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### Financial Management and Governance Issues in the PRC

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<td><strong>Securities Law 1998</strong></td>
<td>This law took effect from 1 July 1999 and governs the issuance and trading of securities. It also emphasizes transparency and information-disclosure. Article 161 requires that organizations and individuals that prepare documents such as audit reports, asset-appraisal reports and legal opinions for the issuance or listing of securities or for securities trading activities must do so in accordance with the working procedures prescribed in the rules of their profession. It requires that they check and verify the truthfulness, accuracy and completeness of the contents of the reports to be produced by them and shall bear joint and several liability for the parts of such reports for which they are responsible. Article 167(3) stipulates that the CSRC is responsible for regulating the activities of public accounting firms that are engaged in the securities business.</td>
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**Administrative Law (Fourth level)**

The key body of administrative law (i.e. regulations, rules, decisions, and orders) in relation to financial management arrangements is as follows:

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<tr>
<td><strong>CICPA Charter (1996)</strong></td>
<td>The Charter was issued under Article 34 of the CPA Law 1993 and specifies the objectives and functions of CICPA, the Institute's membership structure, the Institute's management structure and procedures, and members’ rights and duties.</td>
</tr>
<tr>
<td><strong>Accounting Standard for Business Enterprises (1992)</strong></td>
<td>This accounting standard provided the conceptual accounting framework and accounting principles and was based upon International Accounting Standards.</td>
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With the release of the first accounting standard, the MOF published a series of new uniform accounting systems for the major economic sectors. The uniform accounting system regulations and guidelines prescribe, charts of account, reporting formats, and detailed accounting instructions.
Appendix 5. The Accounting Law 1985

Accounting Law of the People’s Republic of China

Adopted at the ninth Meeting of the Standing Committee of the Sixth National People’s Congress on 21 January 1985 and revised in accordance with the Decision on Amending the accounting Law of the People’s Republic of China adopted at the fifth Meeting of the Standing Committee of the Eighth National People’s Congress on 29 December 1993, and revised at the 12th Meeting of the Standing Committee of the Ninth National People’s Congress on 31 October 1999.

Chapter I - General Provisions

Article 1. This Law is enacted for the purposes of standardizing accounting behavior, ensuring that accounting documentation is authentic and complete, strengthening economic management and financial management, improving economic results and safeguarding the order of socialist market economy.

Article 2. State organs, associations, companies, enterprises, institutions and other organizations (hereinafter uniformly referred to as units) must, in handling accounting affairs, abide by this Law.

Article 3. Every unit must set up account books in accordance with law and ensure that they are authentic and complete.

Article 4. The responsible person of a unit shall be responsible for the authenticity and completeness of the accounting work and accounting documentation of his own unit.

Article 5. Accounting offices and accounting personnel shall conduct accounting practice and exercise accounting supervision in accordance with this Law. No unit or individual may be allowed to persecute or retaliate against the accounting personnel who perform their functions and duties in accordance with law and oppose the acts in violation of this Law.

Article 6. The accounting personnel who make notable achievements in earnestly implementing this Law, devoting themselves to their duties and adhering to principles are to be given spiritual or material awards.

Article 7. The financial department of the State Council takes charge of the accounting work throughout the country. The financial departments of the local people’s governments at or above the county level administer the accounting work of their respective administrative areas.

Article 8. The state shall exercise a uniform accounting system. The uniform accounting system of the State shall be formulated and promulgated by the financial department of the State Council in accordance with this Law. Relevant departments of the State Council may, in accordance with this Law and the uniform accounting system of the State, formulate specific measures or supplementary provisions for the implementation of the uniform accounting system of the State applied in the sectors which have special requirements for accounting practice and accounting supervision, and submit them to the financial department of the State Council for examination and approval. The General Logistics Department of the Chinese People’s Liberation Army may, in accordance with this Law and the uniform accounting system of the State, formulate specific measures for the implementation in the Army of the uniform accounting system of the State, and submit them to...
Chapter II – Accounting Practice

Article 9. Every unit must, according to the economic transactions and operational matters that actually occur, conduct accounting, draw up accounting documents, enter account books and prepare financial and accounting reports. No unit may conduct accounting with false economic transactions and operational matters or information.

Article 10. Accounting procedures shall be undertaken and accounting practice conducted with respect to the following economic transactions and operational matters: (1) receipts and disbursement of cash holdings and valuable securities; (2) receipts, issuance, additions, reductions and use of money and articles of properties; (3) creation and settlement of debts and claims; (4) increases and decreases of capital and funds; (5) computation of revenue, expenditures, expenses and costs; (6) computation and arrangement of financial results; (7) other matters that are subject to accounting procedures and accounting practice.

Article 11. A fiscal year starts on January 1 and ends on December 31 of the Gregorian calendar.

Article 12. Renminbi is used as the base currency for bookkeeping in accounting practice. The units whose receipts and expenditures are conducted chiefly in currencies other than Renminbi may select one of them as the base currency for bookkeeping, but the financial and accounting reports prepared shall be converted into Renminbi.

Article 13. Accounting vouchers, account books, financial and accounting reports and other accounting documents must conform to the provisions of the uniform accounting system of the State. Where the accounting practice is conducted with computers, the software thereof and the accounting vouchers, account books, financial and accounting reports and other accounting documents produced therefrom must also conform to the provisions of the uniform accounting system of the State. No unit or individual may forge or alter accounting vouchers, account books and other accounting documents, nor submit false financial and accounting reports.

Article 14. Accounting vouchers shall include original vouchers and recording vouchers. In handling the economic transactions and operational matters stipulated in Article 10 of this Law, original vouchers must be drawn up or obtained, and then promptly filed with the accounting office. Accounting offices and accounting personnel must examine the original vouchers in accordance with the provisions of the uniform accounting system of the State, have power to refuse inauthentic or illegal original vouchers and make reports to the responsible persons of units; return the inaccurate and incomplete original vouchers and require to make amends or supplements in accordance with the provisions of the uniform accounting system of the State. The items entered into original vouchers may not be altered; where there are errors in the original vouchers, the drawing units shall draw up new vouchers or make amends. Where there are errors with respect to amount, the drawing units shall draw up new vouchers, and may not make any amends on the original vouchers. Recording vouchers shall be prepared based on the examined original vouchers and other relater information.

Article 15. Account book entries must be conducted based on the examined accounting vouchers and conform to the provisions of relevant laws, regulations and the uniform accounting system of the State. Account books include general ledgers, detail ledgers, daily books and
other auxiliary account books. Account books shall be entered in accordance with the order of pages continuously numbered. Where there are errors or page partition, number shortage or line skip, amends shall be made in accordance with the methods stipulated in the uniform accounting system of the State, and sealed by the accounting personnel, the person in charge of the accounting office (the accountant in charge). Where accounting practice is conducted with computers, entries and amends of account books thereof shall be in conformity with the provisions of the uniform accounting system of the State.

Article 16. The economic transactions and operational matters conducted by every unit shall be entered and calculated in the account books set up according to law and may not be entered and calculated in the account books set up secretly in violation of the provisions of this Law and the uniform accounting system of the State.

Article 17. Every unit shall regularly check the accounting records with physical assets, cash holdings and relevant information and ensure that accounting records conform to the actual amount of the physical assets and cash holdings, accounting records conform to the relevant contents of the accounting vouchers, accounting records conform to one another and accounting records conform to the relevant contents of the accounting statements.

Article 18. Accounting arrangement methods adopted by every unit shall remain consistent from one period to another and may not be arbitrarily changed. Where changes are absolutely necessary, the changes shall be made in accordance with the provisions of the uniform accounting system of the State, and the reasons therefore circumstances and effects of the changes shall be explained in the financial and accounting reports.

Article 19. Probable matters such as guaranty provided by the units or pending litigation of the units, etc. Shall be explained in the financial and accounting reports in accordance with the provisions of the uniform accounting system of the State.

Article 20. Financial and accounting reports shall be prepared based on the examined accounting book records and relevant documents. They must be in conformity with the provisions of this Law and the uniform accounting system of the State on matters relating to the requirements for the preparation thereof, to whom they are required to be submitted to, and to the time limit within which they must be submitted. Where other laws and administrative regulations stipulated otherwise, such provisions should be applied. Financial and accounting reports are composed of accounting statements, the affiliated notes to the accounting statements and the explanatory statements on financial conditions. The basis for the preparation of financial and accounting reports provided for different users shall be consistent. Where the relevant laws or administrative regulations stipulate that the accounting statements, the affiliated notes thereto and the explanatory statements on financial conditions are subject to audit by certified public accountants, the auditing reports issued by the certified public accountants and the accounting firms to which the certified public accountants belong shall be submitted together with the financial and accounting reports.

Article 21. Accounting and financial reports shall be signed and sealed by the responsible person of the unit, the executive officer in charge of accounting work, and the person in charge of the accounting office (accountant in charge). For unit having an accountant-general, the accountant-general shall also sign and seal
the financial and accounting reports. The responsible person of the unit shall ensure the authenticity and the completeness of the financial and accounting reports.

Article 22. The language used in accounting records shall be Chinese. In an autonomous area of minority nationalities, one minority language commonly used in the locality may be used concurrently with the Chinese language in the accounting records. The accounting records of foreign-invested enterprises, foreign enterprises and other foreign organizations within the territory of the People's Republic of China may also use one foreign language concurrently.

Article 23. Every unit shall establish achieves for accounting vouchers, account books, financial and accounting reports and other accounting documents, and properly keep them. The time limit for keeping the accounting archives and the procedures for their destruction shall be formulated by the financial department of the State Council jointly with the relevant departments.

Chapter III – Special Provisions on the Accounting Practice of Companies and Enterprises

Article 24. The accounting practice of a company or an enterprise shall be in conformity with the provisions of this Chapter, in addition to the provisions of Chapter II of this Law.

Article 25. Companies and enterprises are required to confirm, calculate and record assets, debts, owners' equities, revenues, expenses, costs, and profits in accordance with the provisions of the uniform accounting system of the State on the basis of the economic transactions and operational matters which actually occur.

Article 26. Companies and enterprise may not conduct the following acts: (1) Arbitrarily changing the criteria for the confirmation of assets, debts and owners' equities or changing methods of their calculation, fraudulently listing the assets, debts or owners' equities, listing more or less than their actual amounts, or omitting such items; (2) Fraudulently listing or concealing revenues, delaying to confirm revenues or confirming revenues in advance; (3) Arbitrarily changing the criteria for the confirmation of expenses or costs, or changing the method of their calculation, listing the expenses and costs fraudulently, listing more or less than the actual amounts of expenses or costs, or omitting such items; (4) Making arbitrary adjustment on the methods of calculation or distribution of profits, fabricating false profits or concealing profits; (5) Other acts violating the provisions of the uniform accounting system of the State.

Chapter IV – Accounting Supervision

Article 27. Every unit shall set up and improve its internal accounting supervision system. The internal accounting supervision of a unit shall meet the following requirements: (1) The staff making accounting records, the persons responsible for approval of economic transaction and operational matters and that responsible for accounting matters, and the staff handling accounting matters for matters for the safe keeping of properties shall all have clear, separate responsibilities, powers and functions. They shall check on each other in performing their functions. (2) The procedures for mutual supervision and mutual checks on the decision-making and its implementation on important economic transactions and operational matters, such as important external investment, the disposal of assets, the operation of funds etc., shall be explicit and clear. (3) The scope, time limit and organizational procedures for checking of properties shall be explicit and clear. (4) The measures and procedures for regular internal auditing of accounting documents shall be explicit and clear.
Article 28. The responsible person of a unit shall ensure that the accounting office and the accounting personnel perform their functions legally. They may not incite, instigate or forcibly order the accounting office or the accounting personnel of the unit to handle it accounting matters in violation of law. The accounting offices and the accounting personnel shall have the right to refuse to handle it or to correct within their authorities the accounting matters in violation of the provisions of the uniform accounting system of the State.

Article 29. When accounting offices or accounting personnel find that the accounting book records are inconsistent with the physical assets, cash holdings or the relevant documents, and where they have the authorities to handle it on their own according to the provisions of the uniform accounting system of the State, they shall handle it timely. Where they do not have the authorities, they shall report immediately to the responsible person of the unit and request to make investigation on the causes and to handle it accordingly.

Article 30. Any unit or individual shall have the right to report on violations of the provisions of this Law or of the uniform accounting system of the State. Upon receiving such a report, the department having the power to deal with it according to law shall, within its functions and responsibilities, deal with it timely according to law. Where it does not have such authority, it shall refer it timely to the department having such authority. The department having received such report and the department responsible for dealing with it shall keep confidentiality for the reporting person and may not disclose the name of the reporting person, nor forward the reporting material to the unit or the individual being reported.

Article 31. Where a unit is subject to audit by certified public accountant in accordance with the provisions of the relevant laws and administrative regulations, the unit shall provide truthfully accounting vouchers, account books, financial and accounting reports and other accounting documents as well as the relevant information to the delegated accounting firm. Any unit or individual may not, in any way, ask or express implicitly their intention to the certified public accountant and the accounting firm to which the certified accountant belongs to issue false or inappropriate auditing report. The financial departments shall have the authorities to supervise on the procedures of the preparation of and on the contents of the auditing report.

Article 32. The financial departments shall supervise on the implementation of the following matters of every unit: (1) Whether accounting books are set up according to law; (2) Whether accounting documents, account books, financial and accounting reports and other accounting documents are authentic and complete; (3) Whether its accounting practice is in conformity with the provisions of this Law and the uniform accounting system of the State; (4) Whether the accounting personnel have acquired the qualification for accountant's practice. Where serious suspicion of violation of law is found in the process of supervision on matters listed in item (2) of the preceding paragraph, the financial department of the State Council and its agencies may inquire into the relevant facts from units that have economic transactions with the supervised unit and from financial institutions with which the supervised unit maintains accounts. Such relevant units and financial institutions shall render their assistance.

Article 33. Financial department, auditing department, tax administration, People's Bank, securities supervision and regulatory body, insurance supervision and regulatory body etc., shall conduct
supervision and inspection on the accounting documents of the relevant units in accordance with the provisions of the relevant laws and administrative regulations on their functions and responsibilities. The supervision and inspection departments listed in the preceding paragraph shall provide a conclusion after the inspection has been conducted according to law. Where the conclusions made by the relevant supervision and inspection departments are sufficient to satisfy the needs of other supervision and inspection departments in performing their functions, such other supervision and inspection department shall make use of them so as to avoid repeated auditing.

Article 34. The departments and the persons conducting supervision and inspection on the accounting documents of the relevant units according to law shall have the obligation of keeping confidentiality of the State secret and commercial secret obtained in the process of supervision and inspection.

Article 35. Every unit shall, in accordance with the provisions of the relevant laws and regulations, accommodate the supervision and inspection conducted by the relevant supervision and inspection departments, provide truthfully accounting vouchers, account books, financial and accounting reports as well as other accounting documents and the relevant information. It may not refuse to provide, or conceal or fraudulently report these documents and the relevant information.

Chapter V – Accounting Offices and Accounting Personnel

Article 36. Every unit shall, according to the needs of its accounting work, set up an accounting office, or staff a relevant office with accounting personnel and designate an accountant in charge. Where conditions do not permit, the unit shall delegate its bookkeeping to an intermediary organization, which is established upon approval to be engaged in agency operation of accounting bookkeeping. A large or medium-sized enterprise owned by the State or in which the State-owned assets occupy a holding or leading position must have an accountant-general. The qualifications, appointment or removal procedures as well as functions and powers of the accountant-general are to be stipulated by the State Council.

Article 37. An accounting office shall establish an internal auditing system. The staff handling disbursements and receipts may shall not be concurrently in charge of auditing, taking custody of accounting archives or entering the receipts, expenditure, expense or claims and liability accounts.

Article 38. A person who is engaged in accounting work must acquire an accountant's practice qualification certificate. Anyone who is to be the person in charge of the accounting office of a unit (accountant in charge), in addition to acquiring an accountant's practice qualification certificate, must have professional technical qualifications equal to or higher than those for accountants or have been engaged in accounting work for more than 3 years. Measures on the administration of accounting personnel's practice qualifications shall be stipulated by the financial department of the State Council.

Article 39. Accounting personnel shall abide by professional ethics and improve their professional qualifications. The work of education and training of accounting personnel shall be enhanced.

Article 40. Persons who are investigated for criminal liabilities according to law for providing untruthful financial and accounting reports, making false accounts, concealing or intentionally destroying
accounting vouchers, account books as well as financial and accounting reports, embezzlement, misappropriating public funds, taking possession of properties by taking advantages of positions or for other illegal acts relating to their accounting positions may not acquire or acquire again accountant’s practice qualification certificates. Besides the persons as stipulated in the preceding paragraph, persons who have their accountant’s practice qualification certificates revoked for violating laws and disciplines may not acquire the accountant’s practice qualification certificates again within 5 years of the date of the revocation of such certificates.

Article 41. Accounting personnel who are being transferred to other work or leaving their posts must finalize the handing-over procedures with the persons who are taking over. The person in charge of the accounting office (accountant in charge) shall supervise handing-over procedures for ordinary accounting personnel. The responsible person of a unit shall supervise handing-over procedures for the person in charge of the accounting office (accountant in charge); when necessary, the unit in charge may send personnel to participate in the supervision of the handing-over.

Chapter VI - Legal Liability

Article 42. Where the provisions of this Law are violated by committing one of the following acts, the financial department of the people's government at or above the county level shall order to make amends within a specified time limit, may simultaneously impose a fine of not less than Y3,000 but not more than Y50,000 upon the unit, and may impose a fine of not less than Y2,000 but not more than Y20,000 upon the persons in charge that bear direct responsibilities and other persons directly responsible. The persons who are State functionaries shall also be imposed upon administrative sanctions according to law by the unit to which they belong or the unit concerned: (1) No account books are set up according to law; (2) Account books are set up secretly; (3) Original vouchers are drawn up or obtained not conforming to the provisions or original vouchers drawn up or obtained are not in conformity with the provisions; (4) Account books are recorded on the basis of accounting vouchers which are not examined and verified or account books are recorded not conforming to the provisions; (5) The measures for accounting arrangement are arbitrarily changed; (6) The basis for preparing financial and accounting reports provided to different users of accounting documents is inconsistent; (7) Failure to use in accordance with the provisions the account recording language or the base currency for bookkeeping; (8) Failure to keep in accordance with the provisions the accounting documents, and thus resulting in destruction and loss of such accounting documents; (9) Failure to establish and implement in accordance with the provisions the internal accounting supervision system of the unit, or refusing supervision conducted according to law or untruthfully providing the relevant accounting documents as well as relevant information; (10) The appointment of accounting personnel is not in conformity with the provisions of this Law. Where one of the acts as stipulated in the preceding paragraph is committed and therefore a crime is constituted, criminal liabilities shall be investigated according to law. Where accounting personnel commit one of the acts as stipulated in Paragraph 1 and the circumstances are serious, the financial department of the people's government at or above the county level shall revoke their accountant’s practice qualification certificates. Where punishments against the acts as stipulated in Paragraph 1 are otherwise provided in the relevant laws,
the matter shall be handled in accordance with such provisions.

Article 43. Where accounting vouchers or account books are counterfeited or altered, or altered, or false financial and accounting reports are prepared, and therefore a crime is constituted, criminal liabilities shall be investigated in accordance with law. Where the acts as stipulated in the preceding paragraph are committed but no crimes are constituted, the financial department of the people's government at or above the county level shall circulate a notice, may simultaneously impose a fine of not less than ¥5,000 but not more than ¥100,000 upon the unit, and may impose a fine of not less than ¥3,000 but not more than ¥50,000 upon the persons in charge that bear direct responsibilities and other persons directly responsible. The persons who are State functionaries shall also be imposed upon administrative sanctions according to law from removing from post up to expelling from the units by the unit to which they belong or the unit concerned; for the accounting personnel among them, the financial department of the people's government at or above the county level shall additionally revoke their accountant's practice qualification certificates.

Article 44. Where accounting vouchers, account books or financial and accounting reports that should be kept according to law are concealed or intentionally destroyed, and therefore a crime is constituted, criminal liabilities shall be investigated in accordance with law. Where the acts as stipulated in the preceding paragraph are committed but no crimes are constituted, the financial department of the people's government at or above the county level shall circulate a notice, may simultaneously impose a fine of not less than ¥5,000 but not more than ¥100,000 upon the unit, and may impose a fine of not less than ¥3,000 but not more than ¥50,000 upon the persons in charge that bear direct responsibilities and other persons directly responsible. The persons who are State functionaries shall also be imposed upon administrative sanctions according to law from removing from post up to expelling from the units by the unit to which they belong or the unit concerned; for the accounting personnel among them, the financial department of the people's government at or above the county level shall additionally revoke their accountant's practice qualification certificates.

Article 45. Anyone who incites, instigates or arbitrarily orders accounting offices, accounting personnel and other persons to counterfeit or alter accounting vouchers or account books, to prepare false financial and accounting reports, or to conceal or intentionally destroy accounting vouchers, account books as well as financial and accounting reports that should be kept according to law, and therefore constitutes a crime, shall be investigated for criminal liabilities in accordance with law; a fine of not less than ¥5,000 but not more than ¥50,000 may be imposed if no crime is constituted, and the persons who are State functionaries shall also be imposed upon administrative sanctions of demoting to a lower rank, removing from post or expelling from the units according to law by the unit to which they belong or the unit concerned.

Article 46. Where the responsible person of a unit persecutes or retaliates against the accounting personnel, who perform their duties according to law and oppose acts violating the provisions of this Law, by means of demoting to a lower rank, removing from post, transferring working post, dismissing from employment or expelling from the units, etc., and therefore constitute crimes, criminal responsibilities shall be investigated in accordance with law; if no crime is constituted; administrative sanctions shall
be imposed according to law by the units
which belong or the unit
concerned. For the accounting personnel
who are persecuted or retaliated against,
their reputation, original positions and
ranks shall be resumed.

Article 47. Functionaries in financial
departments and relevant administrative
departments who abuse their powers,
eglect their duties, commit illegalities for
personal interests or by fraudulent means,
or disclose State secrets or commercial
secrets, and therefore constitute crimes,
shall be investigated for criminal liabilities
in accordance with law; administrative
sanctions shall be imposed if no crime is
constituted.

Article 48. Anyone who, in violation of the
provisions in Article 38 of this Law,
transfers the name of the reporting person
and reporting materials to the unit
reported and the person reported shall be
imposed upon administrative sanctions
according to law by the unit to which he
belongs or the unit concerned.

Article 49. Where the provisions of both
this Law and other laws are violated
simultaneously, sanctions shall be
imposed according to law by the relevant
departments within their respective
functions and powers.

Chapter VII - Supplemental Provisions

Article 50. For the purpose of this Law,
the meanings of the following terms are:
The responsible person of a unit refers to
the legal representative of a unit or the
person in charge stipulated by laws and
administrative regulations who performs
functions and powers on behalf of the
unit. The uniform accounting system of
the State refers to the system concerning
accounting practice, accounting
supervision, accounting offices and
accounting personnel as well as
administration of accounting work which
are formulated by the financial
department of the State Council in
accordance with this Law.

Article 51. The specific measures governing
the accounting of individual industrial and
commercial business operators shall be
formulated separately by the financial
department of the State Council in
accordance with the principles of this
Law.

Article 52. This Law takes effect as of the
date of 1 July 2000.
Appendix 6. The Certified Public Accountants Law 1993

Law of the People's Republic of China on Certified Public Accountants
(31 October 1993)

Chapter I - General Principles

Article 1. This law is formulated with an aim at defining the role of Certified Public Accountants (CPAs) in the economy and society, reinforcing regulation over CPAs, protecting public interests and the legitimate rights and interests of investors, and promoting the healthy development of the socialist market economy.

Article 2. A CPA is a practising accountant who has lawfully received the certificate of CPA and accepts assignments for auditing, accounting consultation or other accounting related services.

Article 3. An accounting firm is an organization lawfully established which performs professional accounting services. A CPA must be a member of an accounting firm to perform professional accounting services.

Article 4. An institute of CPAs is a professional organization formed by CPAs. The Chinese Institute of Certified Public Accountants is the national organization of CPAs. The institute of CPAs of a Province, an autonomous region, or a municipality directly under the central government is a local organization of CPAs.

Article 5. The Finance Department of the State Council, and the finance departments of provinces, autonomous regions and municipalities directly under the central government shall supervise and provide guidance to CPAs, accounting firms and institutes of CPAs according to the law.

Article 6. CPAs and accounting firms must observe the laws and administrative regulations in the performance of professional activities. CPAs and accounting firms shall perform professional services in an independent and fair manner, and are protected by the law.

Chapter II - Examination and Registration

Article 7. A national uniform examination system for CPAs shall be conducted by the State. The Finance Department of the State Council shall promulgate the regulations of the examination, and CICPA shall administer the examination in accordance with the regulations.

Article 8. Chinese citizens who have completed at least a two-year college program at a recognized institution or who have achieved a middle-ranked technical title in accounting or subjects related to accounting can apply to take the national uniform examination of CPAs. Certain parts of the examination can be exempted for those who hold high-ranked technical titles in accounting or subjects related to accounting.

Article 9. Those who have passed the national uniform examination of CPAs and have been engaged in the auditing services for more than two years can apply to the institutes of CPAs of provinces, autonomous regions, and municipalities directly under the central government for registration as CPAs. An institute of CPAs should approve the application except under the conditions specified in Article 10 of this law.

Article 10. The registration application should be rejected under any of the following conditions:
1) For those who suffer from mental impairment;
2) For those who have been convicted of a crime and whose sentence was not completed more than five years from the date of registration application;
3) For those who committed serious professional misconduct in finance, accounting, auditing, business administration or other economic management activity, and was at least subject to administrative disciplinary measure or discharge of position. Such candidate may apply to register as a CPA two years after the date of decision of the disciplinary action;
4) For those whose certificate of CPA was suspended within the last five years;
5) For those whose application is subject to rejection under any other regulations promulgated by the Finance Department of the State Council.

Article 11. An institute of CPAs shall submit the list of names of applicants who are approved for registration to the Finance Department of the State Council. If the Finance Department of the State Council discovers any applicant on the list who is not qualified according to the regulations of this law, it shall direct the institute of CPAs concerned to invalidate such applicant's registration. When an institute of CPAs rejects applicant's registration according to Article 10 of this law, it should inform the applicant in writing within 15 days from the date of the decision. An applicant may appeal such action to the Finance Department of the State Council and the finance department of the people's government of a province, an autonomous region or a municipality directly under the central government within 15 days from the date of receipt of the notice of invalidation of registration and recall of certificates.

Those whose registration has been invalidated can reapply for registration, but their application must conform to the requirements of Article 9 and Article 10 of this law.

Chapter III – Service Scope and Rules

Article 12. For those whose applications for registration are approved, an institute of CPAs shall issue Certificates of CPA in the manner prescribed by the Finance Department of the State Council.

Article 13. The institute of CPAs, which issued the Certificate of CPA, shall invalidate and recall the Certificate of CPA under the following conditions that occur after the issuance of the Certificate of CPA:
1) For those who have developed mental impairment;
2) For those who have been convicted of a crime;
3) For those who committed serious professional misconduct in finance, accounting, auditing, business administration or other economic management activity and have received at least an administrative disciplinary measure or discharge from position;
4) For those who have voluntarily suspended their professional activities as a CPA for more than one year.

Those whose Certificates of CPA have been invalidated but have objections should appeal to the Finance Department of the State Council or the finance department of the people's government of a province, an autonomous region or a municipality directly under the central government within 15 days from the date of receipt of the notice of invalidation of registration and recall of certificates.

Those whose registration has been invalidated can reapply for registration, but their application must conform to the requirements of Article 9 and Article 10 of this law.

Article 14. Only CPAs may undertake the following professional auditing activities:
1) Examining the financial statements of an enterprise and issuing an auditing report;
2) Verifying the capital of an enterprise and issuing a capital verification report;
3) Performing audits related to any merger, splitting or liquidation of an enterprise, and issuing relevant reports;
4) Performing other auditing activities as established in the laws and administrative regulations.

The reports issued by CPAs in their lawful execution of auditing activities have the full force and effect of verification documents.

Article 15. A CPA may undertake accounting consultation and other accounting-related service activities.

Article 16. Any assignments undertaken by a CPA must be accepted by the accounting firm to which such CPA belongs, and the contracts of assignments must be signed by that firm and the clients.

The accounting firm assumes all civil liabilities for any professional services undertaken by any CPA associated with the firm.

Article 17. A CPA in the execution of his professional activities may investigate according to the necessity of the situation, the client's relevant accounting information and documents, examine the client's business site and facilities, and require his client to provide necessary assistance.

Article 18. A CPA who has a conflict of interest with, or a financial interest in, a client must avoid dealing with that client. The client also has the right to require such avoidances.

Article 19. A CPA has the responsibility to keep the business information he acquires in the performance of his services confidential.

Article 20. A CPA shall refuse to issue any relevant report where:

1) A client suggests overtly or covertly that a false or misleading report or statement be issued;
2) A client intentionally fails to provide relevant accounting information and documents;
3) The report to be issued by a CPA cannot correctly present the material items of financial information due to a client’s other unreasonable demands.

Article 21. When performing auditing services, A CPA must issue reports pursuant to the procedures as determined in the professional standards and regulations.

A CPA may not commit any of the following errors or commissions in the performance of an audit or the issuance of a report:

1) Omitting any fact of variance between a client's financial and accounting treatments in material items and the State regulations, provided the CPA is fully aware of such fact;
2) Issuing an untrue report or a report which fails to disclose the fact that a client's financial and accounting treatments will damage the interests of the users of the reports or other related parties, provided the CPA is fully aware that the report is untrue or that a material fact has not been disclosed;
3) Issuing a report in which a client's financial and accounting treatments will be misleading to the users of the report or the persons who have interest in the report, provided the CPA is fully aware that the report is misleading;
4) Issuing a report in which the material items of the financial statements are materially untrue, provided the CPA is fully aware that any such statements are materially untrue. A CPA shall be liable for the behavior listed in the above items only if he or she should know the situation
under the professional standards and rules.

Article 22. A CPA may not:
1) Purchase or sell the stock bonds or other properties of an audited organization or individual during an audit;
2) Solicit or accept compensation of any sort beyond the agreed upon price, or try to obtain any other interest by taking advantage of the position of auditor;
3) Accept the assignment of collecting a client’s receivables;
4) Allow others to execute professional activities in his or her name;
5) Execute professional activities with two or more accounting firms;
6) Solicit business by advertising or publicizing his or her professional qualifications;
7) Conduct other activities contrary to the laws and regulations.

Chapter IV - Accounting Firms

Article 23. Two or more CPAs in partnership can establish an accounting firm.

The partners are responsible, with their property as security, for the liabilities of the accounting firm held in partnership in proportion to the amount of capital each partner contributed to the firm, or as provided in the partnership agreement. The partners have joint liability for the firm’s liabilities.

Article 24. An accounting firm which conform to the following conditions can be a legal entity with limited liability:
1) With a registered capital of not less than Y300,000;
2) With a number of full-time professional staff and at least five of them are CPAs;
3) Conforming to the scope of professional activities and other conditions as stipulated by the Finance Department of the State Council.

An accounting firm with limited liability is responsible for its liabilities with all its assets.

Article 25. The establishment of an accounting firm shall be approved by the Finance Department of the State Council or the finance department of a province, an autonomous region or a municipality directly under the central government.

To apply for the establishment of an accounting firm, the applicant must submit the following documents to the organization that examines and approves the application:
1) Application report;
2) Name, organization structure and business location of the accounting firm;
3) The constitution of the firm. If the firm has a partnership agreement, the partnership agreement should be attached;
4) List of the names of CPAs, their resumes and other relevant supporting documents;
5) List of the names of the principals, partners of the accounting firm, their resumes and other relevant supporting documents;
6) Capital verification report of the accounting firm with limited liabilities;
7) Other documents as required by the organization that examines and approves the application.

Article 26. The organization that examines and approves the application should decide whether the application shall be approved within 30 days from the date of the receipt of the application documents.

The finance department of a province, an autonomous region or a municipality directly under the central government shall record the approval of an accounting
firm with the Finance Department of the State Council. In case the Finance Department of the State Council discovers that the approval is improper, it must notify the organization where the original approval was made and require a re-examination within 30 days from the date of the receipt of the record.

Article 27. The establishment of a branch office of an accounting firm must be approved by the finance department of a province, an autonomous region or a municipality directly under the central government where the branch office is located.

Article 28. An accounting firm shall pay tax pursuant to the law.

An accounting firm shall establish a fund for professional liability or purchase a professional liability insurance policy, pursuant to the regulations promulgated by the Finance Department of the State Council.

Article 29. An accounting firm may accept an assignment independently of the administrative or industrial jurisdiction except to the extent of any limitations in any other laws or regulations.

Article 30. No organization or individual shall interfere in an organization's choosing an accounting firm for professional services.

Article 31. The stipulations in Articles 18 through 21 of this law shall also be applied to accounting firms.

Article 32. An accounting firm shall not violate any provisions of items 1-4, 6 or 7 of Article 22 of this law.

Chapter V - Institute of CPAs

Article 33. A CPA shall join an institute of CPAs.

Article 34. The Charter of CICPA shall be drawn up by the Assembly of Delegates, and shall be recorded with the Finance Department of the State Council. The Charter of the institute of CPAs of a province, an autonomous region or a municipality directly under the central government shall be drawn up by its Assembly of Delegates of a province, an autonomous region or a municipality directly under the central government, and shall be recorded with the finance department of a province, an autonomous region or a municipality directly under the central government.

Article 35. CICPA shall establish professional standards and rules for CPAs. These standards and rules shall be reported to the Finance Department of the State Council and shall take effect upon their approval.

Article 36. The institutes of CPAs shall support CPAs pursuant to the laws on the execution of their professional activities, shall protect their lawful interests, and report to relevant organizations their opinions and suggestions.

Article 37. The institutes of CPAs shall conduct annual examination on professional qualification and annual practice inspection of CPAs.

Article 38. An institute of CPAs shall obtain the legal person status as an association.

Chapter VI - Legal Responsibilities

Article 39. Any accounting firm violating the regulations of Article 20 or Article 21 of this law shall be given a disciplinary warning by the finance department of the government at provincial level or above. Any income from illegal activities shall be expropriated and they can be fined from the same amount to five times the amount of such illegal income. In serious cases, all business operations can be suspended or terminated by the finance department of the province or above.

Any CPA violating the regulations of Article 20 or Article 21 of this law shall be given a disciplinary warning by the
finance department of the government at provincial level or above. In serious cases, the finance department of the government at provincial level or above can suspend all professional activities or invalidate the certificate of such CPA.

Any accounting firm of CPA violating the regulation of Article 20 or Article 21 of this law and issuing false auditing reports and false capital verification reports intentionally shall be investigated pursuant to the criminal law.

Article 40. The finance department of the government at provincial level or above shall order any organization which accepts assignments without special approval of the professional activities of CPAs as regulated in Article 14 of this law to stop such illegal activities, shall expropriate all illegal income and may impose a fine from twice to five times the amount of such illegal income.

Article 41. If a litigant refuses to accept any disciplinary punishment, an appeal may be submitted to the next higher organization within 15 days of the receipt of the notice of disciplinary action. The litigant may also directly file a suit with a people's court within 15 days of the receipt of the disciplinary action.

The organization that evaluates the appeal shall render its decision within 60 days of the receipt of such appeal. If the litigant refuses to accept the decision on appeal, the litigant may file a suit with a people's court within 15 days of receipt of the decision on appeal. If the organization which evaluates the appeal does not render a decision by the due date, the litigant may file a suit with a people's court within 15 days of the due date.

The organization which made the original disciplinary decision may petition a people's court to enforce the execution of the decision if the litigant neither appeal nor file a suit with a people's court nor comply with the disciplinary decision by the date specified in such decision.

Article 42. An accounting firm which violates any regulation of this law and causes damage to a client or other relevant party shall be liable for such damage pursuant to the law and shall compensate such party for any such loss.

Chapter VII - Supplementary Articles

Article 43. A certified public auditor working in an auditing firm can execute the professional activities regulated under this law provided the certified public auditor's qualifications are determined to be the same as those of a CPA. Such determination together with the supervision, guidance and regulation over certified public auditors shall be made pursuant to regulations to be promulgated separately by the State Council.

Article 44. Foreigner's application for participating in the national uniform CPA examination of China and their registrations shall be conducted under the principle of reciprocity. The establishment of representative office of a foreign accounting firm in China must be reported to and approved by the Finance Department of the State Council. The application for the establishment of a Sino-foreign joint venture accounting firm jointly run by a foreign accounting firm and a Chinese accounting firm must be examined and agreed upon by the department in charge of foreign economic relations ad trade of the State Council or the departments as authorized by the State Council and the governments at provincial level before being reported to and approved by the Finance Department of the State Council.

Any foreign accounting firm which seeks to temporarily perform relevant professional activities in China in cases in addition to those which have been mentioned above must obtain approval from relevant finance department of the
government of a province, an autonomous region or a municipality directly under the central Government.

Article 45. The State Council may promulgate regulations necessary to enforce any provision under this law.

Article 46. This law takes effect on 1 January 1994. The Regulations on CPAs of the People's Republic of China issued on July 3 1986 by the State Council is repealed at that time. (This is an unofficial translation.)
Appendix 7. CICPA Charter 1996

Charter of the Chinese Institute of Certified Public Accountants
(June 5 1996)

Chapter I - General Provisions

Article 1. This charter is stipulated according to the Law of the People's Republic of China on Certified Public Accountants and the Law of the People's Republic of China on Audit.

Article 2. The institute of certified public accountants is an association consisting of the Certified Public Accountants (CPAs). The Chinese Institute of Certified Public Accountants is a national organization of CPAs. The institute of CPAs of a province, an autonomous region, or a municipality directly under the central government is local organization of CPAs.

Article 3. The mission of the Chinese Institute of Certified Public Accountants (hereinafter referred to as the Institute) is: serving, supervising, regulating and coordinating. To serve Certified Public Accountants, accounting firms and auditing firms (hereinafter referred to as the Firms). To serve the socialist market economy; to supervise the service quality and professional ethics of CPAs and the Firms. To regulate the CPA profession under the law; to coordinate the relationship within and beyond the profession and protect the legitimate rights of members; 8) To undertake activities of international exchanges and cooperation; 9) To provide guidance to provincial CPA institutes on their operations; 10) To handle other affairs as stipulated in State laws and regulations or authorized by government agencies.

Chapter II - Functions and Responsibilities

Article 5. The Institute has main functions and responsibilities as follows: 1) To handle the registration of CPAs and the Firms, to supervise and regulate their practice; 2) To recruit and regulate the members of the Institute; 3) To draw up professional standards and rules of CPAs and monitor and inspect their implementation; 4) To organize and promote professional training; 5) To organize and implement the National CPA Examination; 6) To approve overseas accounting firms and professionals to conduct business in China, and to supervise and regulate their practice in China; 7) To organize business discussions and conduct theoretical research; and to coordinate the relationship within and beyond the profession and protect the legitimate rights of members; 8) To undertake activities of international exchanges and cooperation; 9) To provide guidance to provincial CPA institutes on their operations; 10) To handle other affairs as stipulated in State laws and regulations or authorized by government agencies.

Chapter III - Members

Article 6. The membership of the institute is divided into group membership, individual membership and honorary membership. All firms approved according to the law shall become group members of the Institute. All those who have passed all the subjects of the National CPA Examination and have been approved after submitting applications or those who were qualified through the former evaluation procedures shall become individual members of the Institute. If recommended by relevant parties and approved by the Council, well-known figures at home and abroad shall be awarded honorary membership.
Article 7. Members of the Institute are entitled to the following rights: 1) The right to elect and to be elected in the Institute; 2) Participating in the learning and activities of training sponsored by the institute; 3) Participating in the professional study and activities of experience exchange sponsored by the Institute; 4) Obtaining relevant materials from the Institute; 5) Putting forward through the Institute suggestions and requests to the relevant agencies; 6) Supervising the performance of the Institute and giving criticisms and suggestions; 7) Supervising the Institute's revenue and expenditures of membership fees; 8) Apply to leave the Institute.

Article 8. Members of the Institute have the following duties: 1) To accept the Charter of the Institute; 2) To carry out the decision made by the Institute; 3) To abide by the discipline of the Institute; 4) To accept the supervision and administration of the Institute; 5) To pay membership fee on time; 6) To complete the continuing professional education as stipulated by the Institute; 7) To undertake the task entrusted by the Institute.

Article 9. Should a member fail to perform his duty, the Council may request him to leave the Institute or remove his name from the membership's list.

Article 10. The governing rules on the Institute's members shall be drafted by the secretariat of the Institute and take effect upon approved by the Council.

Chapter IV - Assembly of Delegates

Article 11. The highest authority of the Institute is the Assembly of Delegates. The Assembly convenes every three years and may be moved up ahead of schedule or postponed when necessary, but the Assembly should not be postponed for more than one year. The delegates are chosen by election, consultation or special invitation.

Article 12. The Assembly of Delegates has the following main powers: 1) To approve and amend the charter of the Institute; 2) To elect the Council of the Institute; 3) To determine the policies and tasks of the Institute; 4) To review and approve the work report of the Council of the Institute; 5) To review and approve the report on revenue and expenditures of membership fees of the Institute; 6) Other powers which are entrusted to the Assembly of Delegates.

Chapter V - Council and Executive Committee

Article 13. The Council consists of a number of directors elected by the Assembly of Delegates. Directors shall serve a three-year term and may be re-elected. The plenary session of the Council shall be held once a year and could be moved up ahead of schedule or postponed if necessary.

Article 14. The Council shall be responsible to the Assembly of Delegates. Its powers and responsibilities are: 1) To hold the general meeting of the Assembly of Delegates; 2) To elect the members of Executive Committee of the Institute; 3) To elect the leading members of the Institute; 4) To recommend or engage the leading members of the secretariat of the Institute; 5) To make addition to or replace Council members of the Institute; 6) To review the setting up of functional departments of the secretariat of the Institute's Council; 7) To review and approve the annual work report of the secretariat of the Institute's Council; 8) To review and approve the annual report on revenue and expenditures of membership fees of the secretariat of the Institute's Council; 9) Other items which should be dealt with by the Council.

Article 15. The plenary meeting of the Council shall appoint several honorary presidents. The plenary meeting of the Council shall elect a president, number of
vice presidents, and number of executive directors. President, vice presidents and executive directors shall have the same term as director.

Article 16. The Executive Committee shall exercise authority of the Council at the closing sessions of the Council.

Article 17. The President on behalf of the Institute convene and chair the Council meeting, the Executive Committee meeting and the general meeting of the Assembly of Delegates. The president shall supervise and inspect the implementation of the decisions of the meetings.

Chapter VI - Permanent Office

Article 18. The Council shall establish a secretariat, which shall be the permanent office of the Institute.

Article 19. The plenary meeting of the Council shall elect or engage a secretary-general and number of deputy secretaries-general, and report to the competent finance department of the government for approval.

Article 20. The Secretary-General shall take charge of the daily operation of the secretariat; the deputy secretaries-general shall assist the secretary-general in his or her work. The proposal of setting up functional departments in the secretariat should be put forward by the Secretary-General and then be reviewed by the Council before reported to the competent finance department of the government for approval.

Chapter VII - Consultative Committee and Special Committee

Article 21. The Institute shall set up a consultative committee and engage number of advisors.

Article 22. The Council shall set up several special committees.

The plan of setting up special committees and its duties, and of the appointment and dismissal of members of committees, shall be put forward by the secretary general of the Institute, and then reported to the Council for approval.

Chapter VIII - Local Institutes of CPAs

Article 23. The institute of CPAs of a province, an autonomous region or a municipality directly under the central government shall become the local organization of CICPA. Their constitutions shall be worked out by the local Assembly of Delegates pursuant to the law, and reported to the Institute and the competent department of the local government for the record.

Article 24. The setting up of an institute of CPAs below a provincial level should be approved by the provincial CPA institute, and filed with the Institute. The organization structure and the duties of such an institute should be worked out according to relevant laws and regulations of the State and the rules of the provincial CPA institute where it is located.

Article 25. The members of the institute from aboard, Hong Kong, Macao and Taiwan, can respectively organize a local friendship association or a branch of the Institute with approval of the Council of the Institute, and its organization structure and way of activities should be stipulated by other rules.

Chapter IX - Financial Resources

Article 26. The financial resources of the Institute shall come from: 1) financial allocation from the government; 2) membership fee; 3) public donation; 4) revenue from the operating activities of the Institute; 5) other revenue.

Chapter X - Supplementary Rules

Article 27. The English name of the institute is: The Chinese Institute of Certified Public Accountants, and its abbreviation is CICPA.
Article 28. The termination of the Institute should be raised by the Council, and be agreed by more than two-thirds delegates of the Assembly.

Article 29. The location of the head office of the Institute shall be in Beijing.

Article 30. This charter shall take effect on the date when the Special Meeting of the Assembly passes it.
Appendix 8. Relevant Extracts from the Securities Law 1998

The Securities Law of the People's Republic of China

(Adopted by the Sixth Session of the Ninth National People's Congress [NPC] Standing Committee on 29 December 1998)

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Chapter I - General Provisions

Article 1. The formulation of this law aims to regulate stock issuance and transactions, to protect investors' legitimate rights and interests, to safeguard economic order and public interests of the society, and to enhance the development of the socialist market economy.

Article 2. This law will be applicable to the issuance and transactions of shares, company bonds, and other securities designated by the State Council according to law within China's territory. The provisions of the Company Law, other laws, and administrative rules and regulations will cover situations that are stipulated in this law. The issuance and transactions of government treasury bonds will be governed separately by the provisions of other laws and administrative rules and regulations.

Article 9. According to law, the state auditing organ shall supervise by auditing the accounts of stock exchanges, securities companies, securities registration and settlement organizations, and securities supervision and administration organizations.

Chapter II - Stock Issuance

Chapter III - Trading of Securities

Article 58. According to the regulations of the Company Law, a company that has been approved by the securities regulatory body under the State Council to list its stocks in accordance with law or by the department authorized by the State Council to issue its bonds in accordance with the law shall publish its prospectus or its measures for raising bonds. The company that issues new stocks or bonds in accordance with the law shall also publish its financial accounting report.

Article 59. The documents published by a company regarding the issuance and listing of its stocks or bonds shall be true, accurate, and complete and no fake records, misleading statements, or major omissions are allowed.

Article 60. A company that has listed its stocks or bonds shall submit a mid-term report with the following information to the securities regulatory body under the State Council and to the stock exchanges.
within two months after the end of the first half-year of each accounting year. Such documents shall also be published. (1) The company's financial accounting report and management situation; (2) Major lawsuits involving the company; (3) The changes of stocks and bonds already issued; (4) Major matters submitted to the general meeting of stockholders for examination; and (5) Other matters stipulated by the securities regulatory body under the State Council.

Article 61. A company that has listed its stocks or bonds shall submit an annual report with following information to the securities regulatory body under the State Council and to the stock exchanges within four months after the end of each accounting year. Such documents shall also be published. (1) The company's general situation; (2) The company's financial accounting report and management situation; (3) The resumes of directors, supervisors, managers, and high-ranking administrators as well as the situation regarding their holding of the company's stocks and bonds; (4) The situation concerning stocks and bonds already issued, including the name list of the top 10 stock holders of the company and the numbers of their stocks; and (5) Other matters stipulated by the securities regulatory body under the State Council.

Article 62. When a major incident occurs that might have a fairly large impact on the price of its listed stocks and the investors have no knowledge of the incident, a listed company shall immediately submit an interim report on the incident to the securities regulatory body under the State Council and the stock exchanges. It shall also publish the report to explain the facts of the incident. The following situation can be termed as major incident stated in the preceding paragraph: (1) Major changes of a company's management policy and management scope; (2) The company's decision concerning its major investment and major property purchase; (3) Major contracts signed by the company which might have an important influence on the company's assets, liabilities, rights, interests, and management results; (4) The company incurs major debts or fails to repay those debts that have come due in violation of an agreement; (5) The company experiences major economic losses or major economic losses which exceed more than 10 percent of its net assets; (6) Major changes occur in the external conditions of the company's production and management; (7) There is a change in the chairman or more than one third of directors or managers of the company; (8) There is fairly large change in the holding of stockholders who hold more than 5 percent of the company's stocks; (9) The company's decisions to reduce capital, merge with another company, establish a separate company, disband, and apply for bankruptcy; (10) Major lawsuits involving the company and the court's canceling in accordance with law the decisions adopted by the general meeting of stockholders and the board of directors; and (11) Other matters stipulated by the regulations of laws and administrative rules.

Article 63. When the prospectus released by an issuer, or an underwriting securities company, and its corporate bonds placement measures, financial and accounting reports, listed reports, annual reports, interim reports, and provisional reports contain falsified or misleading information or important omissions that result in losses for investors during securities trading, the issuer and the underwriting securities company shall be liable for compensation, and the issuer and the liable board directors, supervisors, and managers of the underwriting securities company shall also be liable for compensation.
Article 64. Announcements that must be made by the law or by administrative regulations shall be published in newspapers and magazines authorized by relevant departments of the state, or in special bulletins. These announcements shall also be available at various companies and securities trade centers for the public to read.

Article 65. The securities regulatory body under the State Council shall supervise listed companies' annual reports, interim reports, and provisional reports, as well as the state of the announcements. They shall also supervise the state of listed companies' new stock apportionment and distribution. Securities regulatory bodies, securities exchanges, and underwriting securities companies and their personnel shall not prematurely leak out the contents of the public announcements which these companies are required to announce by the law and administrative regulations.

Article 66. The securities regulatory body under the State Council shall make timely announcements of the names of those listed companies which have had their listing credentials revoked owing to major lawless conduct, or which are not qualified to operate as listed companies. When a security exchange makes the decision mentioned in the paragraph above, it shall promptly make the announcement and report the announcement to the securities regulatory body of the State Council for the record.

Chapter IV - Takeover of Listed Companies

Chapter V - Stock Exchanges.

Chapter VI - Securities Companies.

Chapter VII - Securities Registration and Settlement Organizations.

Article 159. The professionals in securities investment consultation institutions are not allowed to carry out the following activities: (1) Invest in securities on behalf of their clients; (2) Arrange to share the profits or losses of their clients' securities investments; (3) Buy or sell the stocks of listed companies served by their institutions; or Other activities prohibited by laws or administrative regulations.

Article 160. Professional securities investment consultation institutions and credit evaluation institutions shall charge service fees according to the standards or procedures stipulated by the relevant administrative department of the State Council.

Article 161. Professional institutions and personnel in charge of issuing documents such as audit reports, asset evaluation reports, or legal advice related to the issuance, listing, or transactions of securities must issue such documents according to the work procedures specified by professional rules. They must verify and confirm the truthfulness, accuracy, and completeness of the contents of such reports, and assume joint liability for those parts they are responsible for.

Chapter IX - The Stock Brokers' Association

Chapter X - The Securities Regulatory Body.

Article 166. The State Council's securities regulatory body shall supervise and administer the securities market according to law, maintain order in the market, and ensure the market operates in a lawful manner.

Article 167. The State Council's securities regulatory body shall carry out the following supervisory and administrative duties in regards to the securities market: (1) Formulate rules and regulations related to the supervision and administration of the securities market according to law and exercise its examination and approval power according to law; (2) Supervise and
administer according to law the issuance, transactions, registration, trusteeship, and settlement of securities; (3) Supervise and administer according to law the securities-related activities of securities issuers, listed companies, stock exchanges, securities firms, securities registration and settlement institutions, securities investment fund management institutions, securities investment consultation institutions, and credit evaluation institutions, as well as law firms, accounting firms, and asset evaluation institutions involved in the securities business; (4) Formulate standards of qualifications and codes of conduct for securities professionals and supervise the implementation of such standards and codes according to the law; (5) Supervise and inspect according to the law the public disclosure of information on securities issuance and transactions; (6) Guide and supervise according to the law the activities of the stock brokers' association; (7) Investigate and handle according to the law any conduct that violates the laws and administrative regulations formulated for the supervision and administration of the securities market; and (8) Other duties stipulated by laws and administrative regulations.

Article 168. While executing its duties according to the law, the securities regulatory body under the State Council is entitled to take the following measures: (1) To enter premises where an illegal act has been committed to investigate and to attain evidence; (2) To question people involved, and units and individuals related to the incident under investigation, and to demand that they explain relevant issues related to the incident under investigation; (3) To read, check, and duplicate the records of securities transactions, the records of transfers of securities, financial accounts, and other relevant documents and materials of the people involved, and the units and individuals related to the incident under investigation. It can seal up and keep documents and materials that may be removed or hidden. (4) To check the funds accounts and securities accounts of the people involved, and the units and individuals related to the incident under investigation. When there is evidence that such funds and securities may be transferred or hidden, it can apply to freeze them at a judicial organ.

Chapter XI - Legal Liability Article

Article 182. Specialized organs providing auditing reports, assets assessment reports, legal opinion documents, or other documents, for the issuing or marketing of stocks, and their workers, who buy or sell stocks in violation of Article 39 of this law, are to be ordered to dispose according to the law of their illegally obtained stocks. Their illegal earnings are to be confiscated and they are to be fined for an amount not more than the value of the stocks in question.

Article 202. If a specialized organ that provides auditing reports, capital assessment reports, written legal views, or other documents relevant to the issuance and marketing of securities and securities trading is found to have falsified anything that is in its charge, its illegitimate income shall be confiscated, it shall be fined for a sum that is between one and five times that of the illegitimate income, and the relevant authorities shall order this organ to suspend its business and shall revoke the credentials of its persons in charge. This organ shall also be liable for compensation for any loss. It shall also be held accountable for its criminal conduct by law if the falsification constitutes a crime.

Chapter XII - Supplementary Provisions

Article 214. This law goes into effect on 1 July 1999.