

**REPORT ON THE OBSERVANCE OF STANDARDS AND CODES (ROSC)
– ACCOUNTING AND AUDITING**

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ABBREVIATIONS AND ACRONYMS

A&A	Accounting and Auditing
ASBE	Accounting Standards for Business Enterprises
ASSE	Accounting System for Small Enterprises
CAS	Chinese Accounting Standards
CASB	China Auditing Standards Board
CASC	China Accounting Standards Committee
CBRC	China Banking Regulatory Commission
CICPA	The Chinese Institute of Certified Public Accountants
CICSC	China Internal Control Standards Committee
CIRC	China Insurance Regulatory Commission
CNAO	China National Audit Office
CNY	Chinese Yuan
CPA	Certified Public Accountant
CPD	Continuing professional development
CSA	China Standards on Auditing
CSRC	China Securities Regulatory Commission
EU	European Union
FSB	Financial Stability Board
HKICPA	Hong Kong Institute of Certified Public Accountants
IAASB	International Auditing and Assurance Standards Board
IAS	International Accounting Standards
IASB	International Accounting Standards Board
IASC	International Accounting Standards Committee
IES	International Education Standards
IESBA	International Ethics Standards Board for Accountants
IFAC	International Federation of Accountants
IFRIC	International Financial Reporting Interpretation Committee
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
ISA	International Standards on Auditing
MOF	Ministry of Finance
NAI	National Accounting Institute
PRC	People's Republic of China
ROSC	Reports on the Observance of Standards and Codes
SASAC	State-owned Assets Supervision and Administration Commission
STA	State Administration of Taxation
XBRL	Extensive Business Reporting Language

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PREFACE

There is a broad agreement among the international financial community that the observance of international standards and codes are pivotal in strengthening national and international financial architecture. This was again emphasized in the G-20 Summits held April and September 2009 in London and in Pittsburg, respectively, in context of the global financial turmoil. The Reports on the Observance of Standards and Codes Accounting & Auditing (ROSC A&A) is one of 12 modules jointly developed by the World Bank and IMF soon after the Asian financial crisis in 1997. These modules were developed in order to assess a country's strengths and weaknesses of actual practices regarding the various components of financial architecture.

The ROSC A&A review focuses on the institutional framework regulating the accounting and auditing practices, and the comparability of national accounting and auditing practices with international standards and best practice, using International Financial Reporting Standards and International Standards on Auditing as benchmarks. The review evaluates the effectiveness of enforcement mechanisms for ensuring compliance with applicable standards and codes. The final draft report is submitted to the country authorities for comment, approval, and permission to publish. Once agreed, the report is published on the World Bank's website. An overview of the ROSC A&A Program, including rationale and detailed methodology are available at http://www.worldbank.org/ifa/rosc_aa.html

The World Bank team wishes to express its appreciation and thanks to the Chinese Government, and in particular to the Vice Minister of Finance, Mr. Wang Jun. Under the coordination of Mr. Liu Yuting, Director-General of Accounting Regulatory Department, Ministry of Finance, the ROSC A&A exercise was carried out in China from November 2008 to September 2009 through a participatory process involving in-country stakeholders, including the Government (MOF, SASAC, CNAO); regulators (CBRC, CSRC, CIRC); accounting professionals (CICPA); banks; insurance companies; state-owned enterprises; accounting firms; corporate accountants; and academics. The World Bank team gratefully acknowledges the valuable and extensive contributions of the counterpart team at the Ministry of Finance and other in-country stakeholders.

The China ROSC A&A benefited from valuable inputs and guidance from Iraj Talai (Manager, Financial Management, East Asia and Pacific Region). The ROSC A&A report was prepared by a World Bank team comprising David I (Senior Financial Management Specialist and Task Leader), Yi Dong (Senior Financial Management Specialist and Co-Task Leader), M. Zubaidur Rahman (Program Manager, OPCFM, and Study Adviser), and Humayun Murshed (consultant).

EXECUTIVE SUMMARY

China has made impressive progress putting in place institutional framework for accounting, auditing, and corporate financial reporting. Since the beginning of introducing market economic system, the Chinese Government gave significant attention to modernizing accounting standards in line with international good practice. China has been implementing a well-designed strategy for convergence of Chinese Accounting Standards with International Financial Reporting Standards. Similar steps have been taken with regard to the implementation of International Standards on Auditing. Under the leadership of the Ministry of Finance, the Chinese strategy for improving the quality of accounting and auditing standards and practices has evolved as a good practice model that may be followed by other countries. With the high level of Government commitment to continue the path it has taken for full convergence with international standards and good practice, the ROSC team believes that, with the implementation of the recently developed roadmap, China expects to achieve its continuing and full convergence with the international standards in 2012.

The objectives and focus of the ROSC A&A, as designed and implemented around the world, are to report on the comparability of national accounting and auditing standards with international standards, and assess the strengths and weaknesses of the institutional frameworks that underpin actual practices of accounting and auditing in each country under review. Given the many good outcomes and interesting lessons, the China ROSC A&A also provides a summary description of the processes, which led to China's achievements in this area.

Recognizing the fact that proper implementation of high-quality accounting standards depends on the corporate accountants, practicing auditors, and relevant regulators, the Chinese authorities have focused on strengthening capacity in these three areas. Building on past achievements, more efforts need to be given to further enhance the capacity of the regulators in order to ensure compliance with applicable standards more efficiently and effectively. The accountancy profession has grown, in line with international good practice, under the supervision of the Ministry of Finance. In order to keep pace with China's developmental needs, there is a need for further strengthening of the accountancy profession throughout the country. Further improving and maintaining the quality of accounting and auditing practices outside major cities of China poses an important challenge for the Chinese authorities.

The report outlines interrelated, principle-based policy recommendations. These recommendations are to build on the existing system in China and contribute to the international body of knowledge on the process of bolstering the corporate financial reporting infrastructure.

I. BACKGROUND

1. This assessment of accounting and auditing (A&A) practices in China is part of a joint initiative of the World Bank and the International Monetary Fund (IMF) to prepare Reports on the Observance of Standards and Codes (ROSC) covering 12 internationally recognized standards and codes relevant to economic stability and private and financial sector development. The main objective of ROSC A&A is to review and report on the rules and standards governing the practice of accounting, auditing, and reporting by companies and professionals; on the way these rules and standards are put in practice and complied with; and on the mechanisms, systems, and structures to monitor and enforce compliance with public interest in mind. The focus of this report is on the strengths and weaknesses of the accounting and auditing environment that influence the quality of corporate financial reporting and involves a review of both mandatory requirements and actual practice. It uses International Financial Reporting Standards (IFRS)¹ and International Standards on Auditing (ISA)² as benchmarks and draws on international experience and good practice in the field of accounting and audit regulation. However, given the impressive achievements of China in this area, this report also describes in summary steps and processes that made such achievements possible with the hope that the lessons from China can serve others.

2. **The ROSC A&A assessment adopted a participatory approach with a strong involvement of policymakers and other country stakeholders.** The stakeholders included regulators of corporate entities, banks and similar financial institutions, professional accountants, bankers and investment analysts, preparers of financial statements, auditors, and academics. The assessment used a diagnostic tool, which facilitates capturing a comprehensive review of the institutional framework underpinning accounting and auditing practices in China. The information gathered through this diagnostic tool was supplemented by a due diligence exercise in capturing primary experiences of stakeholders and other facts on corporate financial reporting practices in China.

3. **The People's Republic of China (PRC) has been one of the world's fastest growing economies for more than three decades.** Having an average growth rate of about 9.7 percent per annum since the late 1970s has helped to lift several hundred-million people out of absolute poverty, with the result that China alone accounted for over 75 percent of poverty reduction in the developing world over the last 20 years.³ Rapid economic growth and favorable government policies have promoted employment in urban areas; while rural income in real terms grew by 9.5 percent. The global financial crisis is likely to limit growth in China in 2009 and 2010; nevertheless, it is likely to outgrow most other countries.

¹ In this report, IFRS refers to the International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB), the International Accounting Standards (IAS) issued by IASB's predecessor International Accounting Standards Committee (IASC), and the applicable interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC).

² ISA are issued by the International Auditing and Assurance Standards Board (IAASB) of the International Federation of Accountants (IFAC).

³ World Bank, *Country Partnership Strategy for the People's Republic of China for the Period 2006 – 2010*.

4. **China continues to modernize its market regulations.** Part of this modernization includes the restructuring and transformation of state-owned enterprises to listed companies. However, the state is still retaining the largest and controlling shareholding of many of these listed companies. Founded in 1990, the Shanghai Stock Exchange and Shenzhen Stock Exchange are regulated by the China Securities Regulatory Commission (CSRC). Instruments traded on both Stock Exchanges include A-shares and B-shares,⁴ bonds, closed-end mutual funds, and repos. Apart from B-shares, all instruments are traded in local currency. While significant progress has been achieved and reforms are generally heading in the right direction, increasing the share of institutional investors remains a major challenge. In order to overcome this challenge, there is a need to continue the current initiatives for enhancing the quality of corporate financial reporting, and to further strengthen the effectiveness of monitoring and enforcement mechanisms, which will have impact on enhancing investor confidence in corporate financial information.

5. **China's financial sector has undergone significant market-oriented reforms since 1978.** The Central Bank Law 1994 and the Commercial Bank Law 1995 further deepened China's financial reform. These laws allow the state-owned banks to concentrate on commercially oriented lending and emphasize the need for financial institutions to incorporate commercial criteria into their lending practices, including the adoption of standard accounting and prudential norms. Since 1978, a number of non-state-owned banks entered the financial system (e.g., urban and rural credit cooperatives, trust and investment companies, and finance companies). Nevertheless, the level of capital mobility still appears to be low and China's financial markets remain fragmented across regions. Surveys and studies show that private Chinese firms are constrained in their access to credit due to poor lending practices and underdeveloped bond and equity markets.⁵

II. INSTITUTIONAL FRAMEWORK

6. China has made significant strides in putting in place the institutional framework for improving corporate accounting, auditing, and financial reporting practices. The framework, salient features of which are discussed below, as a whole seems comprehensive and robust. Since all elements of this framework are well anchored and players have developed good habits, it will adequately respond to needs of the national financial system with effect on the international financial architecture. Additionally, in order to face future challenges, continuation of mechanisms and good practice now in place would allow a timely update as circumstances change in future. This dynamic aspect of the framework is an interesting and important feature not observed in all countries and is particularly noteworthy. Furthermore, the framework and its implementation by different actors would benefit from a sharpening of the focus on efficiency and effectiveness.

⁴ *A-shares* are traded by companies incorporated in PRC; traded in Shanghai and Shenzhen. *B-shares* are traded by companies incorporated in PRC and traded in Shanghai in U.S. dollars and Shenzhen in Hong Kong dollars.

⁵ Aziz, J., *Real and Financial Sector Linkages in China and India* (IMF Working Paper, 2008).

Statutory Framework

7. **Over the last 30 years, China’s legislative and regulatory regime applicable to accounting and auditing of corporate entities, banks, and similar financial institutions has improved significantly.** Such improvements are primarily geared toward the needs of transition to the market economy. Substantive amendments have been made in the Company Law, Securities Law, Tax Law, and laws relating to operation of banks and other financial institutions. Furthermore, an Accounting Law and Law of the People’s Republic of China on Certified Public Accountants were developed with the objective of putting in place a sound institutional framework for regulating accounting, auditing, and corporate financial reporting.

8. **According to the statutory framework of China, the Ministry of Finance (MOF) is primarily responsible for regulating the accounting and auditing practices.** Various regulatory bodies also carry out their regulatory responsibilities in line with related laws. Other regulators work in collaboration with the MOF, and their regulatory activities regarding accounting and auditing are designed for specific purposes. The responsibilities of the MOF include developing principles, issuing regulations, setting standards, ensuring compliance with financial reporting requirements, providing directions and setting requirements for the accounting and audit profession, and carrying out regular inspection and special investigations on the audit services provided by the statutory auditors. Carrying out these responsibilities calls for continued MOF capacity improvement, with MOF personnel trained in complex and up-to-date accounting and auditing requirements in line with international good practice. The MOF has put in place arrangements for continuing professional development of its specialists who work on accounting standard setting and related matters.⁶

9. **The regulatory system of China’s accountancy profession is led by the Government’s administration, accompanied by the professional organization’s activities.** Currently, the MOF is entitled to monitor the performances of accounting firms; and impose administrative sanctions on errant firms, individual certified public accountants (CPAs), and their audit clients. The MOF and CSRC are responsible for registration and supervision of the accounting firms that are qualified to provide audit services to the listed companies. Additionally, the Chinese Institute of Certified Public Accountants (CICPA) conducts its quality review on these accounting firms every three years. The MOF Accounting Department and provincial-level finance bureaus’ accounting divisions are responsible for registering and supervising all other accounting firms. The CICPA is the professional organization that is responsible for registration and management of its members according to CPA law and the CICPA constitution.

10. **The Accounting Law provides the fundamental legal framework for ensuring a uniform accounting, and corporate financial reporting in corporate entities.** Under the Accounting Law, all corporate entities are required to prepare and present financial statements

⁶ During the last 10 years, several staff of the Accounting Department of MOF has spent extended time on learning about programs supported by the IASB, U.S. Financial Accounting Standards Board, Australian Accounting Standards Committee, and similar organizations of other western countries to gain exposure to internationally recognized accounting standards and international good practice on accounting and financial reporting regulations.

in compliance with the unified accounting system of the state. The unified accounting system includes a series of rules and regulations, including the Accounting Standards for Business Enterprises (ASBE).⁷ The Accounting Law defines applicable principles and requirements together with the scope of corporate accounting and financial reporting. It also provides for the preparation of financial statements, their disclosure and audit, and inspection. Uniformity in corporate accounting and financial reporting practices ensures comparability in the financial information, a crucial element of rational decision making in a market economy.

11. The Accounting Law includes provisions to help ensure a true and fair view of enterprises' financial performance is disclosed in their financial reports. Chapter IV of the Accounting Law requires each corporate entity to establish an internal accounting supervision system. This is to ensure that enterprises follow a systematic approach in maintaining books of accounts and preparing financial statements. The top management is not allowed to unduly influence the accounting personnel to manipulate measurement and disclosure of financial information.

12. The Code of Corporate Governance for Listed Companies in China sets specific requirements regarding corporate accounting. The Code was issued by the CSRC in January 2001. Article 25 of the Code requires enterprises to establish sound accounting and financial management system in accordance with applicable standards and codes and without any interference from the controlling shareholders.

13. The Securities Law requires listed companies to submit their interim financial statements to the CSRC. The Securities Law requires the listed companies to prepare both interim (quarterly and half-yearly) and annual financial statements and submit them to the CSRC. The quarterly report must be submitted within one month after the end of each quarter of the financial year, while the half-yearly report is to be submitted within two months after the end of the first half of the financial year. The annual financial statements must be submitted within four months from the end of the financial year. It is mandatory that annual financial statements be audited, but interim financial statements do not have to be audited, except in the following circumstances:

- A company plans to distribute profit, capitalize, or make up loss from general reserves in the second half of the financial year.
- A company plans to issue new shares or convertible bonds for refinancing in second half of the financial year.
- A company meets any other special requirement set by the CSRC.

14. The Securities Law requires listed companies' financial statements to incorporate some non-financial information, which is intended to facilitate the informed decision making process. Article 65 of the Securities Law requires that, apart from providing operating results, listed companies' financial statements should focus on information relating to (a) the general business condition of the company, (b) the company's involvement in any major litigations, (c) changes in the number of shares issued, and (d) any important matters submitted in the annual general meeting for shareholders' consideration. In addition, Article 66 of the Securities Law asks for a brief introduction of the directors and senior managers of the

⁷ The ASBE are also known as Chinese Accounting Standards (CAS).

company, information on the shares and corporate bonds issued, and the top 10 company shareholders and the amount of their held shares. Taking financial and non-financial information together tends to help the readers of financial statements obtain a broader insight into a company's state of affairs.

15. The Company Law outlines management's obligation for the probity of financial statements. The company management is responsible for ensuring timely preparation of annual financial statements reflecting true and fair view of the corporate entity's financial condition and operating results. According to the Article 166 of the Company Law, management is also responsible for submitting the corporate entity's audited financial statements to the general shareholders' meeting within four months from the end of the financial year. Noncompliance with regard to responsibilities for preparing financial statements and making them available to the shareholders could lead to sanctions, including a fine.⁸ The Company Law does not mention that shareholders need to approve the financial statements. However, the right of shareholders to approve the corporate entity's financial statements is important as it allows the corporate owners to check on management's performance and its stewardship of the entity's resources.

16. Except for listed companies, there is no statutory requirement for public interest entities⁹ to allow public access to their financial statements. The audited financial statements of the listed companies, listed banks, and similar financial institutions must be published in a printed annual report, on the Internet, and in newspapers designated by respective regulators. Noncompliance with this requirement could lead to sanctions. Non-listed entities are only required to submit annual financial statements to their respective supervisory bodies without any requirements to make them public. Public availability of the financial statements of public interest entities is very important for a healthy corporate sector adding benefits in terms of transparency, market discipline, and availability of information for making informed and rational investment decisions.

17. Law of the PRC on Certified Public Accountants (CPA Law) regulates the audit profession. The CPA Law defines the notions of audit and accounting firm, specifies the requirements to become an auditor, outlines the rights and obligations of auditors, and specifies the legal status and main responsibilities of MOF, provincial-level finance bureaus, and the CICPA. The CICPA exercises the management and service functions by virtue of the powers vested by the CPA Law, the Charter of the Chinese Institute of Certified Public Accountants, and other relevant laws and regulations. The major statutory functions of the CICPA include implementing policies regarding admission to membership, formulating professional standards and rules for CPAs, organizing the uniform CPA examination, administering programs for

⁸ Various provisions of the Accounting Law, Company Law, and Securities Law outline several sanctions for noncompliance with applicable requirements. In this regard the fine for noncompliance may range from 3,000 Yuan to 100,000 Yuan. The other kinds of sanctions include industrial discipline, criminal detention, civil liability, public condemnation, and confiscating illegal proceeds derived from accounting policy manipulations.

⁹ Within this report, public interest entities are those in which the general public has an interest by virtue of the nature of their business size, their number of employees, or their range of stakeholders. Examples include banks and similar financial institutions; insurance companies; investment funds; pension funds; publicly traded companies, and large enterprises, including large state-owned enterprises.

members' professional development, ensuring adherence to professional ethics and standards, and taking disciplinary actions against erring members.

18. In order to strengthen the quality of listed company audit, the MOF and CSRC require the auditors and accounting firms to meet some specific conditions:

- The firm should have been in operation for more than 3 years.
- Over 50 percent of owners or partners have served this firm for more than 3 years.
- Employed at least 80 CPAs, of which at least 35 should have more than 5 years experience.
- The net assets are not less than CNY5.0 million for a limited liability firm and CNY3.0 million for a partnership.
- The previous year revenue should be at least CNY16.0 million.
- Accumulated risk fund is more than CNY6.0 million.
- No penalty or violation record imposed during the last 3 years.
- No fraudulent information appears in its application package.

19. The MOF and CSRC require the engagement partner of a listed company auditor to be changed at least once in every five years. Although the shareholders have the ultimate authority to hire or fire statutory auditors, in practice the decision to appoint or terminate auditors is mostly exercised by the board of directors. Consideration should be given to this issue by the relevant authorities taking into account the context of China. The statutory regulators, which include MOF, CSRC, China Insurance Regulatory Commission (CIRC), and China Banking Regulatory Commission (CBRC), require notification, together with justification, of any decision made to terminate an existing auditor. Nevertheless, the requirements of these regulators cannot be considered as substitute for a proper governance mechanism that can ensure the independence of external auditors for the benefit of stakeholders. Indeed, the law should clearly outline the grounds for termination of statutory auditors to augment the credibility of information contained in corporate financial statements.

20. In line with international good practice, the Company Law and Securities Law provide for establishment of oversight within the company to explicitly monitor the independent audit process on behalf of shareholders. Good corporate governance practice requires that audit committees oversee the appointment of auditors and their discharge of professional responsibilities, as well as establishing adequate financial control within the entity. The Company Law and the Securities Law require corporate entities to establish board of supervisors and audit committees in order to oversee whether the members of the board of directors' and statutory auditors discharge their mandated responsibilities.

21. The MOF and CSRC require auditors to attend shareholders' general meeting. In particular, this gives the opportunity for the minority shareholders to seek and obtain clarification from the auditor on issues of concern to them. However, there is need for effective monitoring as to whether, in practice, auditors are fulfilling this professional obligation. From various discussions, the ROSC team found that in some cases, representatives of both management and auditors are not aware of auditors' obligation to attend the shareholders' meeting.

22. **The CPA Law outlines auditors' obligations.** Chapter III of the CPA Law allows the statutory auditors to undertake audit and advisory services. The auditors have the right to express their independent opinion upon examining the financial statements. In this regard, they can ask for information and seek clarifications from corporate management in undertaking audit work. In line with International Federation of Accountants (IFAC) requirements concerning *conflict of interest*, the auditors are not allowed to provide various non-audit services to the audit clients.

23. **Article 23 and 24 of the CPA Law allow the accounting firms to be established as either a partnership or a limited liability company.** However, provision for establishing accounting firms as limited liability companies may constrain auditors' accountability to the clients since these accounting firms' liabilities are limited to the company's share capital. Generally, accounting firms are incorporated as a limited liability company with low share capital, which offers little protection to the claimants. The 6 largest accounting firms (in terms of revenue) in China, including members of international network accounting firms, are established as limited liability companies. In China, audit services are to be provided in the name of a firm. Individuals are not allowed to undertake audit services and issue audit reports in the name of individual auditors. The accounting firms must register with MOF or provincial finance bureau to work as statutory auditors.

24. **Auditors are subject to civil and criminal liability.** Auditors are liable for compensation of losses to their clients due to negligence in undertaking audit works and other related services. According to the CPA Law, accounting firms shall establish funds for professional liability or purchase a professional liability insurance policy, pursuant to the regulations promulgated by the Finance Department of the State Council. For noncompliance with mandated obligations in the context of an audit assignment, the auditors can face both administrative and other sanctions that could range from a fine of not less than one time and not more than five times the value of the income from that particular assignment, revocation of audit license, public condemnation, and imprisonment.

25. **The China Banking Regulatory Commission regulates the financial reporting of banks and similar financial institutions in China.** The disclosure requirements set by the CBRC are additional to those stipulated by the Accounting Law. It requires banking institutions to prepare their financial statements within four months after the financial year-end. It also prescribes disclosure requirements, primarily for prudential reporting, that each bank must follow. A MOF/CSRC-approved auditor must perform the audit of listed banks' financial statements whereas, for non-listed banks, any statutory auditor can perform the audit work. Before the audited financial statements are published, a tripartite meeting is held between the auditors, the bank, and the CBRC. Banks are obliged to submit monthly, quarterly, and audited annual financial statements to the CBRC. The CBRC has set up its own standard review procedures in order to determine whether the financial reporting of banks is adequate. The CBRC carries out both on-site and off-site supervision.

26. **Auditors are required to make independent evaluation of the internal control system and risk management of banks.** The CBRC requires statutory auditors, appointed by the banks, to evaluate the internal control system and risk management issues of banks. The

evaluation report is appended to the annual report of the bank. The statutory auditors are obliged to report to the CBRC on any significant noncompliance with applicable standards and codes and any impact on the going concern of bank.

27. The China Insurance Regulatory Commission regulates the financial reporting requirements of insurance companies. The annual financial statements of insurance companies must be audited, and insurance companies are required to submit audited financial statements to the CIRC together with other reports as prescribed monthly, quarterly, and annually for prudential purposes. The audit of listed insurance companies must be performed by MOF and CSRC-approved auditors; however, there is no such requirement for the non-listed insurance companies. The CIRC requires that the insurance companies' financial statements must be verified by external auditors with regard to material issues such as reinsurance activities, capital provisioning, liquidity, commissions, revenues, costs, profits, and profit distribution. Also, it is mandatory for the insurance companies to submit the audited solvency report to the CIRC annually.

28. The stock exchange listing rules require all listed companies to present interim financial statements. The listing rules require all listed companies to publish quarterly financial results, according to a prescribed format. These quarterly financial statements do not require auditing, but the annual financial statements are to be audited by the statutory auditors.

29. Article 91 of the Chinese Constitution empowers the China National Audit Office (CNAO) to undertake audits of state-owned enterprises. The CNAO is responsible for auditing assets, liability, income, and loss of state-owned enterprises; auditing the performance of state-owned enterprises on compliance with responsibilities regarding their financial condition and various financial activities; and providing guidance and supervision to the internal auditing. The government officials responsible for providing guidance on conducting state-owned enterprise audits largely lack exposure to relevant IFAC-issued accounting and auditing pronouncements. In addition to CNAO audit, the listed state-owned enterprises are subject to annual external audit by accounting firms.

The Profession

30. The audit profession is managed by the Chinese Institute of Certified Public Accountants and supervised by the Ministry of Finance. The MOF supervisory oversight of the CICPA is exercised through issuing regulations and recommending senior officials to the CICPA Council.¹⁰ Oversight for ensuring public interest is important for assuring that the quality assurance, investigation, and disciplinary systems are adequate to promote high-quality audits.

31. The CICPA has more than 150,000 members and is a full member of the International Federation of Accountants. The CICPA was established in 1988. It gained

¹⁰ According to the Article 4 of the CPA Law, CICPA is a civil society association. According to Article 5 of the CPA Law, the financial department under the State Council and the financial departments of the people's governments of provinces, autonomous regions, and municipalities directly under the Central Government shall supervise and guide the activities of certified public accountants, public accounting firms, and CICPA, including its branch offices.

full IFAC membership in 1997 with a commitment of compliance with the IFAC Statements of Membership Obligations. Among the CICPA membership, 88,000 are practicing auditors, and more than 70,000 are working as non-practicing professionals.¹¹ The CICPA performs all the functions of a modern professional accountancy body, including granting membership, formulating professional standards for its members, organizing CPA examination, organizing practice review of members, undertaking disciplinary actions against members for violating professional rules, organizing continuing professional development (CPD) programs, and representing the China CPAs in various forums.

32. Minimum competency requirements for membership of the audit profession are determined by MOF. The conditions for becoming an auditor include having passed the CPA examination set by the CICPA, followed by completion of 2 years of work experience; and having no criminal record and administrative punishment within the last 5 years and 2 years, respectively, from the date of registration. The provincial institutes of CPAs in different provinces, autonomous regions, or municipalities are responsible for the CPA registration with general guidance from the CICPA. The MOF inspects the locally administered registration process in order to ensure compliance with applicable rules. The CICPA also formulated a Code of Professional Ethics for its members, which converged with the IFAC's Code of Ethics for Professional Accountants.

33. According to the legal requirements in China, only accounting firms can provide statutory audit services. In order to be registered as an accounting firm, there must be at least two CPA-licensed partners. From this perspective, in order to develop the audit profession, the MOF has played an important role to facilitate merger of sole practitioners throughout the country. At present, there are more than 7,500 accounting firms involved in providing statutory audit services in China. Members of the international networks of accounting firms are among the 60 firms eligible to undertake audits of listed companies in China. Most of these firms provide audit services to the banks and insurance companies in the country. Mostly major accounting firms (both local and internationally affiliated firms) in China audit the listed companies. The small and medium-sized accounting firms perform bookkeeping services, capital verification, and audits for smaller companies.

34. China has strategized the development of 10 big accounting firms capable of providing a full range of accounting and audit-related services on a global scale. As part of the overall strategy for improving the audit profession, the Chinese Government will develop 200 better managed medium-size accounting firms in China within the next 5 years. These 200 accounting firms will focus on providing high quality value-added services to listed-companies and large/medium-size enterprises and public entities. In addition, 10 large and competitive accounting firms will be supported to become international with the capability of serving the needs of the Chinese enterprises going global, and providing the full range of services to globally operating Chinese enterprises. The objective focuses on optimizing accounting firm's scale and structure, implementing the talent strategy,¹² and enhancing the professional competence of CPAs.

¹¹ Most of these non-practicing professionals work as corporate accountants.

¹² Paragraph 41 of this report describes the Leading Accountant Talent Project.

Professional Education and Training

35. In discussion with the ROSC team, many stakeholders expressed concern that new accountancy professionals lack adequate exposure to the practical application of accounting standards, appropriate level of communication skills, and aptitude in forming judgment in applying accounting policies concerning complex recognition and measurement issues. These stakeholders believe that university graduates do not have adequate levels of practical knowledge and are not prepared to deal with the challenges of discharging their professional responsibilities. In most cases, the employers have to spend substantial amount of time and resources to train newly hired accountants to begin their assigned jobs.

36. **The quality of academic education in accounting widely varies among universities.** Only a handful of universities in major cities in China have developed internationally comparable curriculum and teaching arrangements. The universities in remote provinces suffer from the scarcity of well-trained teaching staff. Moreover, Chinese universities have not made an effort to harmonize accounting curricula and establish common minimum requirements for type and content of courses on accounting and auditing. The accounting curricula do not adequately focus on practical application aspects of accounting and auditing standards. Textbooks from the United States are widely used in accounting programs. Textbooks from United Kingdom, Australia, and Canada are also used. Specifically, in the case of using United States textbooks, the students are confronted with the challenges of understanding the accounting environment in the United States. Under such circumstances, the students need help from well-trained and highly knowledgeable teachers. This kind of teachers is not available in many universities. Most of the local accounting textbooks lack adequate focus on international dimensions of accounting and auditing. Some universities' curricula integrate Chinese accounting and auditing standards by launching a major focus on the CPA examination. However, the capacity of academic institutions to teach the practical implications of these standards remains a concern.

37. **The professional accounting curriculum covers important content requirements of International Education Standards (IES).** In 2009 the CPA curriculum has been restructured into a Professional Stage and an Advanced Stage with the incorporation of a new subject – Corporate Strategies and Risk Management – into the Professional Stage. The Professional Stage covers the following subjects:

- Accounting,
- Auditing,
- Financial and Cost Management,
- Economic Law,
- Taxation Law, and
- Corporate Strategies and Risk Management.

The Advanced Stage examination requires candidates to apply knowledge to practical situations. It addresses professional and legal knowledge, professional values, ethics and attitudes, intellectual ability, and inter-personal communication and managerial skills.

38. The MOF-administered examination for accountants largely satisfies the requirements of IES 6, *Assessment of Professional Capabilities and Competence*. Accountants, aspiring either to work as corporate accountants or provide accounting services to the public must pass the MOF-administered examination. This examination is different from the examination, set by the CICPA. The CICPA examination is designed for aspiring auditors; however, those who pass this examination can also work as corporate accountants. The MOF-administered examination has two components – *Accounting Qualification Examination* and *Accounting Professional and Technical Qualification Examination*. In order to be qualified to provide any kind of professional accounting services (not audit services) in China, a person needs to pass the Accounting Qualification Examination. This examination focuses on financial regulation and professional ethics, basic accounting, and computerized accounting. The Accounting Professional and Technical Qualification Examination is a higher-level comprehensive evaluation system. It comprises three-level examinations (junior, middle and senior). The MOF-administered examination system largely appears to test underpinning theoretical knowledge and its practical application, including the judgments to be exercised by accountants in real life circumstances as per IFAC requirements.¹³ Given the fast-growing private sector in China, there is a clear need of accounting technicians in addition to skilled preparers and auditors. The ROSC team views that the MOF-administered examination is useful to encourage growth of the broader profession to ensure that the number of skilled technicians and professional accountants is established to meet market demands.

39. Practicing CPAs are required to participate in a CPD program for a total of 80 hours within 2 years, with a minimum of 30 hours each year. The MOF-qualified accountants are required to have 24 hours of CPD each year. The CICPA, local CPA associations, professional training institutions, and large accounting firms offer various types of CPD programs. The CICPA has been making efforts to improve the quality of the CPD programs, and such efforts need to continue. The CPD programs should focus more on practical implementation aspects of applicable accounting and auditing standards so as to develop and maintain sufficient knowledge and professional skills with regard to modern accounting and auditing practices in the accountancy profession.

40. The National Accounting Institute (NAI) is making arduous efforts to provide high-quality CPD program in China. The Chinese Government established NAIs in Beijing, Shanghai, and Xiamen. The major participants of the NAI program include senior financial managers of state-owned enterprises and medium-size enterprises and CPAs. The NAI-delivered program is better organized compared to many other providers. However, the content and delivery of the program need to be more focused on emerging international developments in accounting and auditing standards. The case studies developed by NAI illustrating the China-specific contexts are certainly a move in the right direction. The CICPA conducts teaching quality checks for the training programs offered by the NIA. Local CPA associations carry out inspection on the quality of training provided by the accounting firms.

41. The Government-sponsored Leading Accounting Talent Project aims to develop professionally qualified accountants capable of facing challenges of internationalization

¹³ IFAC IES 6, *Assessment of Professional Capabilities and Competence*, states that the examination should “require a significant portion of the candidate’s responses to be recorded form” and “cover a sufficient amount of the whole range of professional knowledge, professional skills, and professional values and attitudes.”

of accounting and reporting practices. In 2007, the MOF launched this 10-year plan for creating 1,000 leading accounting talents in China. The candidates are selected from both public and private sector entities and with strong track records in business and management. The training focuses on applicable accounting and auditing standards, professional challenges and values, and international dimension of accounting and auditing practices. The project participants will have a professional attachment with reputable institutions and professional bodies overseas.

Setting Accounting and Auditing Standards

42. The Chinese Accounting Standards (CAS) and the Chinese Standards on Auditing (CSA) are issued by the Ministry of Finance. Under legal mandate, the MOF issues accounting and auditing standards and related regulations.

43. China has established an Accounting Standards Committee composed of representatives from key stakeholders, providing a good platform for development and implementation of the accounting standards. The MOF established the China Accounting Standards Committee (CASC) in 1998. The CASC mainly provides advice on the overall planning, structure, and development of accounting standards; selection of accounting policies; and implementation of accounting standards. In 2003, the CASC was reorganized. The reorganized CASC comprises 26 members appointed by the MOF, drawn from relevant government agencies, academia, professional accounting organizations, and business community. The reorganized CASC has three professional committees: Professional Committee on Accounting Theory, Professional Committee on Accounting Standards for Business Enterprises, and Professional Committee on Accounting for Government and Non-profit Organizations.¹⁴

44. In conformity with international good practice, accounting standards setting follows a due process. The process of setting standards involves the following steps:

- ***Initiating a new project.*** The Accounting Department of MOF initiates a new project for developing a particular accounting standard based on China's economic development need and seeks comments from the members of the CASC and other related parties. Upon receipt of the comments, the Accounting Department develops a proposal for setting the new standard.
- ***Drafting the exposure draft.*** The Accounting Department constitutes a team to prepare an exposure draft based on the proposal for setting the new standard. The exposure draft is submitted to the CASC for their comments.
- ***Soliciting public comments.*** Once the exposure draft is approved, the Accounting Department seeks comments from interested parties by publishing the exposure draft on the CASC website and through other major media.

¹⁴ The current Secretary General of CASC is a Vice Minister for Finance. The secretariat of the CASC is located in the Accounting Regulatory Department of MOF. The Director General of this department also serves as the Director of the CASC secretariat.

- **Preparation of final draft.** The drafting team revises the draft standard based on the comments received and prepares the final draft for the CASC. After reviewing the draft, the CASC submits the standard to the MOF for approval and issuance.

During the period between 2005 and 2007, the MOF organized a series of training programs and workshops in order to deepen the understanding of the CAS. The target audiences for these programs were listed companies, statutory regulators, and members of academia. In addition, the CASC has established a Working Group of Experts on implementation of CAS, drawing membership from CSRC, CBRC, CIRC, the State-owned Assets Supervision and Administration Commission (SASAC), and State Administration of Taxation (STA). This Working Group provides its opinion on material issues encountered during the implementation of CAS.

45. The strategy for convergence of the Chinese Accounting Standards for Business Enterprises with IFRS was put in place in 2005. The MOF developed IFRS-comparable Chinese ASBE system consisting of a Basic Standard, 38 Specific Standards, and Implementation Guidance. The Chinese ASBE system was enacted on February 15, 2006.¹⁵ The CASC members and technical experts of the International Accounting Standards Board (IASB), following an analysis of the various aspects of comparability between CAS and IFRS, came to an agreement on the Chinese convergence strategy. On November 8, 2005, the CASC and the IASB signed a joint statement on the convergence of CAS and IFRS.¹⁶

46. A new full convergence strategy has been developed. In response to the call from the G20 and Financial Stability Board (FSB) on establishing global uniform accounting standards, the MOF has prepared a roadmap for full convergence of CAS with IFRS. As the IASB has planned to complete some major revisions of existing standards by 2011, the timing of full convergence of CAS with IFRS has been planned to align with that date. The MOF has a plan to start revision of CAS at the beginning of 2010 and expects to complete the revisions by end-2011. Implementation of the revised CAS in all large and medium-sized enterprises will start at the beginning of 2012. The composition of the revised accounting standards will include – basic standard, specific accounting standards, and implementation guidance. The basic standard will remain unchanged, and relevant parts of the specific accounting standards will be updated. The new convergence strategy is presented in details in the Appendix to this report.

47. The Ministry of Finance has issued a separate standard for small-size enterprises, outlining simplified financial reporting requirements. In April 2004, the MOF issued the

¹⁵ ASBE and CAS are used interchangeably.

¹⁶ The joint statement showed the following consensus: (a) China stated that convergence is one of the fundamental goals of the country's standard-setting program, with the intention that an enterprise's financial statements prepared under CAS should be same as its financial statements prepared under IFRS. It was further stated that the convergence process should be decided by China. (b) China's accounting standards system for business enterprises is being developed with a view to achieving convergence with IFRS. The two parties acknowledged that differences between CAS and IFRS exist at the present time in a limited number of areas, including reversal of impairment losses, disclosure of related party relationships, and transactions. (c) The IASB identified a number of accounting issues for which China, because of its unique circumstances and environment, could be particularly helpful to the IASB in finding high-quality solutions for IFRS. These include disclosure of related party transactions, fair value measurements, and business combinations of entities under common control.

Accounting System for Small Enterprises (ASSE), which has been effective since January 1, 2005. Small enterprises may choose to follow ASSE or CAS. However, if a small enterprise is a subsidiary company and if its parent company follows CAS, then the particular small enterprise is also required to comply with CAS. For many small enterprises, compliance with financial reporting requirements is a challenge. Moreover, external demand for the financial information from these enterprises is often limited to tax authorities. The simplification introduced by the ASSE is more responsive to the smaller size, simpler transactions and narrower range of stakeholders of the small enterprises. This is a praiseworthy step taken by the MOF, which is worth considering by the developing and emerging market economies.

48. The Ministry of Finance has issued 48 auditing standards, developed by the China Auditing Standards Board (CASB) of CICPA. The CASB, established as an advisory group in 1995 and reorganized as a board in 2005 within CICPA, includes experts from relevant government departments, accounting firms, research institutes, and universities. Following a due process similar to the accounting standards setting (as described in paragraph 44) and in conformance with international good practice, the CASB develops draft standards on auditing for MOF approval. The Chinese Standards on Auditing are largely comparable to IAASB-issued ISA. However, there are two additional CSAs – verification of capital contribution and communication between predecessor and successor CPAs – for which there are no equivalent ISAs. Verification of capital contribution in equity joint ventures forms an important practice area of Chinese CPAs; in the past, several cases involving fictitious verification reports by accounting firms have raised serious concerns over the work of auditors.¹⁷ The Government has now made the verification of capital contribution a statutory audit requirement through the promulgation of various laws and regulations and has made it clear that an untruthful certificate by an auditor is a criminal offence.¹⁸ Communication between predecessor and successor CPAs was adopted for ensuring independence of auditors in situations where Chinese companies frequently change statutory accounting firms. The ISA does not include any such equivalent standard, but related requirements can be found in the IFAC Professional Code of Ethics for Professional Accountants issued by the International Ethics Standards Board for Accountants (IESBA).

49. The MOF and CICPA issue implementation guidance on CAS and CSA. Despite the good practice, these guidance notes need to be expanded further in order to be fully equivalent to the implementation guidance on IFRS and ISA, which inform and illustrate with comprehensive examples and contextual situations to help fully understand the application of each standard. Detailed implementation guidance reduces the knowledge gap among preparers and auditors of financial statements. Consequently, it raises a possibility of applying the standards consistently and minimizing the compliance gaps between applicable requirements and actual practices.

50. The financial sector regulators issue prudential regulations that may have some impact on preparation of general purpose financial statements. In terms of practical application, the CBRC and CIRC issue prudential requirements. The differences between

¹⁷ Tang, Y.W., Chow, L.M., and Cooper, B.J., *Accounting and Finance in China: A Review of Current Practice* (Hong Kong: Sweet and Maxwell, 2000).

¹⁸ Lin, K.Z., and Chan, K.H., “Auditing Standards in China – A Comparative Analysis with Relevant International Standards and Guidelines”, *The International Journal of Accounting*, Vol. 35, No. 4, pp. 559 -77, 2000.

prudential reporting requirements and general purpose financial reporting requirements arise in the banking and insurance sectors, for instance in loan-loss provisioning of banks and calculation of technical reserves in the insurance companies. In some cases, such differences may lead to inconsistencies in application of accounting regulations across banks and insurance companies.

51. Chinese Accounting Standards are recognized as applicable financial reporting standards in various jurisdictions outside China. On December 12, 2008, the European Union (EU) issued relevant decrees deciding that, during the transitional period between 2009 and 2011, the Chinese enterprises that are listed in stock exchanges of EU member countries may prepare financial statements in accordance with the Chinese Accounting Standards. The Hong Kong Institute of Certified Public Accountants (HKICPA) signed a joint statement with the CASC on December 6, 2007, recognizing equivalence of CASC and the applicable accounting standards in Hong Kong. It is worth mentioning that full IFRS is the applicable accounting standards in Hong Kong.

52. The MOF has been translating annual bound volumes of International Accounting Standards and International Financial Reporting Standards since 1980s. These translated standards are used as reference for the development of CAS. The International Accounting Standards Committee (IASC) Foundation recognizes the Chinese edition of IFRS as an official translated publication of IASB. The Chinese-language IFRS is very helpful for the students, teachers, and professionals to have access to the internationally accepted accounting standards.

53. Arrangements have been put in place for convergence of CSA with ISA. In 2005, the China Auditing Standards Board signed a memorandum of understanding with the IAASB for achieving convergence with ISA. In this respect, China has already made significant progress. Also, on December 6, 2007, the CASB and HKICPA signed a joint declaration on the convergence of CSAs and Hong Kong Auditing Standards. The CASB is currently working to produce exposure drafts on updated CSA for public comments. The CICPA has planned to update the CSA with ISA for achieving full convergence by October 2010.

Ensuring Compliance with Accounting and Auditing Standards

54. The MOF took various preparatory steps to support ASBE implementation. In July 2006, MOF launched a nationwide training campaign on the new standards, engaging listed companies, accounting firms that are licensed to provide audit services to the listed companies, accounting academics in higher educational institutions, and relevant regulatory authorities. The training programs focused on practical implementation issues and interpretations of ASBE. More than 10,000 trainees took part in these training programs. At the same time, MOF experts conducted on-site studies in listed companies to identify possible problems of implementation and to determine necessary actions for overcoming those problems.

55. The MOF, in collaboration with the relevant regulatory agencies, closely monitored implementation of the ASBE. The MOF and CASC, assisted by experts from CSRC, CBRC, CIRC, SASAC, and other groups established the Expert Working Group on ASBE Implementation to give advice on emerging issues concerning implementation of the standards. At the same time, through the accounting regulatory bodies of the financial sector in provinces,

autonomous regions, and municipalities, MOF put in place a real-time feedback mechanism in order to detect and resolve the ASBE-implementation problems. The MOF also established a coordination group comprising members from standard setting bodies, securities market regulators, accounting regulatory and inspection bodies, CICPA, and other departments to determine noncompliance with ASBE requirements in corporate financial statements. This helps in monitoring and enforcing the new accounting standards in China.

56. In order to support implementation of the new CAS, MOF has developed a standardized internal control system for enterprises. In July 2006, MOF together with CSRC, CNAO, CBRC, and CIRC launched the China Internal Control Standards Committee (CICSC) to jointly promote the standard system of internal control in China. In June 2008, MOF with another four ministries and commissions jointly issued the *Basic Standard for Enterprise Internal Control* and concurrently issued internal control evaluation guidelines, 22 guidelines on internal control application, and draft supporting guidelines.

57. The MOF Supervision and Inspection Bureau conducts review of company financial statements and practice review of the accounting firms and CPAs. In this regard, a working arrangement has been developed with the accredited agencies of MOF in provinces and provincial financial bodies. On the basis of the results of audit practice reviews, 60 accounting firms have been licensed to provide audit services to listed companies. Each of the accounting firms is subjected to practice review once in a three-year period. The practice review conducted by the MOF Supervision and Inspection Bureau covers internal risk control, compensation system, audit practice quality, and other related aspects. When infractions are found, the MOF and provincial financial bodies determine the appropriate sanctions ranging from warning, fines, penalties, temporary suspension of audit practice, and up to withdrawal of practice license.

58. The CSRC has instituted forward-looking arrangements to enforce financial reporting requirements by listed companies. The CSRC reviews corporate financial statements of listed companies for the purpose of monitoring and enforcement of applicable standards. In addition, CSRC undertakes the review of audit practice. Out of 60 licensed accounting firms that are eligible to audit listed companies, more than 50 percent of these firms were reviewed by the CSRC at the end of 2008. According to the CSRC plan, these licensed accounting firms will be reviewed at least once in every three years. In conducting the accounting firm review, when necessary, the CSRC contracts with technical experts from other accounting firms. The CSRC focuses on internal quality assurance systems and auditors' compliance with applicable standards. The CSRC has established a 'professional integrity and ethical track record system' in its review process. It records basic information of the accounting firm, inspection results, and any penalties imposed. There are instances when CSRC has initiated administrative sanctions against statutory auditors for their wrong doings. Based on the review results, the MOF and CSRC re-assess the qualification of accounting firms on providing statutory audit services to listed companies. The review results are shared with the CICPA along with recommendation for action based on the nature of infraction.

59. There is a need for improving oversight of the quality of financial reporting and auditing of non-listed public interest entities. Although these entities are regulated by their relevant government authorities, scrutiny over the quality of their financial statements and/or

their accounting firms is not as robust as those of listed enterprises. The absence or weakness in monitoring and enforcement of financial reporting requirements for public interest entities poses a significant threat in ensuring good governance and developing a sound financial system in a country. Many of the non-listed entities in both financial and non-financial sectors in China, including state-owned enterprises and credit cooperatives, have significant public interest. However, their accounting and auditing activities are not subject to strong monitoring and enforcement, as in the case of listed companies. As a result, economic decisions regarding those entities might end up not being based on credible financial information. In the financial sector, it is unclear what sanctions could be imposed if non-listed banks and the credit cooperatives do not fully comply with applicable accounting and financial reporting requirements. Given the public sensitivity of these entities, the concerned authorities might wish to review this area and consider putting in place appropriate arrangements while taking into account the Chinese realities and circumstances.

60. **The CBRC needs to have a mechanism to regularly review the general purpose financial statements of banks and other financial institutions to ensure compliance with the financial reporting requirements.** The CBRC enforcement actions are mostly limited to specific problematic cases, either raised by the statutory auditors or any other regulators like CSRC, or as a by-product of monitoring and enforcing prudential regulations. The CBRC primarily relies on examination of prudential reports and their own investigations. Since the prudential norms set by the CBRC generally address risk issues and prudential capital adequacy, both off-site and on-site supervisors give priority to checking the compliance with these requirements during their examinations.

61. **The CNAO has the power to impose administrative punishments for violating the financial management and reporting rules by state-owned enterprises.** In order to discharge this responsibility more effectively, the CNAO needs to have adequate number of technically qualified people who can review the financial statements and identify accounting and auditing noncompliance with respect to international good practice.

62. **The stock exchanges' monitoring and enforcing mechanism regarding financial reporting and disclosure requirements needs further improvement.** The stock exchanges work in collaboration with the CSRC and its local resident offices. Sanctions for significant noncompliance by the listed companies are carried out by the CSRC. The Shanghai and Shenzhen Stock Exchanges, as part of monitoring compliance with the listing rules, review financial statements filed by the listed companies. The listed companies use the XBRL system for filing financial statements. In the recent past, the stock exchange reviewers have identified manipulations with regard to accounting estimates in various companies. However, due to shortage of highly skilled human resources, the stock exchanges find it difficult to efficiently conduct financial statement reviews. Most common sanction for noncompliance is in form of a warning letter. If significant noncompliance is found, the issuer is asked to make corrections and re-issue the financial statements.

63. **The CICPA conducts auditors practice review.** Based on review results, the CICPA has taken some punitive measures against auditors for their noncompliance with applicable standards and requirements. The CICPA has two committees – disciplinary committee and complaints committee – to deal with any infractions detected through the review. The

committees consist of representatives from the industry, accounting and auditing experts, lawyers, and other members of the community. Based on the recommendation of the committees, CICPA initiates actions against the wrongdoers. The professional disciplinary measures are divided into 3 categories: public condemnation, circulating a notice of criticism within the profession, and reprimand, which are all recorded in the professional regulatory information system of the CICPA. An effective review mechanism can ensure that accounting firms have adequate quality control arrangements in place and can enhance stakeholder and investor confidence in China's accounting and auditing practices. In this regard, the ROSC team views that the CICPA is well placed to play an important role with regards to the external quality assurance system, both through strengthening its own practice reviews and supporting the audit practice review of listed companies by the CSRC. Therefore, CICPA should work for continuously strengthening the procedure for reviewing the audit practice and focusing more on the quality assurance of accounting firms.

64. **The CIRC needs to further improve the mechanism for ensuring full compliance with financial reporting requirements.** The CIRC inspectors review the annual returns and financial statements of insurers for compliance with both prudential and financial reporting requirements. However, the focus tends to be more on compliance with prudential requirements. The CIRC primarily relies on auditor reports for ensuring compliance with the applicable accounting standards rather than independently reviewing the financial statements. Given improvement in the quality of the financial statements of insurance companies and the increase in the number of insurers, CIRC concentrates their reviews on a selected number of insurance companies so that this process is more effective and efficient.

III. ACCOUNTING STANDARDS AS DESIGNED AND AS PRACTICED

65. **The CAS and IFRS are basically comparable.** The memorandum signed between CASC and IASB in 2005 identified two major differences between the two sets of standards. These are (a) reversal of impairment losses and (b) disclosure of related party relationships and transactions. In January 2008, CASC and IASB established a continuing convergence mechanism. Meetings between the two parties in April and October 2009 helped to identify and eliminate some differences between CAS and IFRS. In August 2009, the IASB decided to exempt from the disclosure requirements for transactions between a government-controlled reporting entity and that government or other entities controlled by that government. This exemption would ensure CAS convergence with IFRS in respect of related party relationships and transactions.

66. **As is relatively common in many countries, tax rules tend to influence the preparation of general purpose financial statements.** This often deters the fair presentation of financial information. In order to satisfy the requirements of taxation authorities with regard to the recognition of taxable revenues and deductible expenses, the preparers of general purpose financial statements often tend to deviate from applicable financial reporting standards, preferring to follow the taxation regulations. As a result, treatment of certain items in the general purpose financial statements may be different from that which should apply under the CAS. The ROSC team, through facilitated discussion with various stakeholders, observed that the preparers of financial statements have the ability to manipulate accounting policies in

revenue recognition and inventory valuation to reduce their tax liabilities.

67. Companies and their auditors face a number of practical constraints in implementing CAS. Most of these problems arise from the lack of adequate expertise among the corporate accountants who find it difficult to prepare financial statements in accordance with the CAS requirements. It has been observed that some corporate accountants and auditors face considerable difficulties in applying the concepts of fair value and impairment losses in implementing applicable standards. Moreover, some accountants and auditors lack industry-specific knowledge with regard to application of relevant CAS.

68. Given China's economic size, there appears a shortage of high-quality and credible expertise on the valuation of property, plant, and equipment. This sometimes limits the reliability of valuations used on privatization, business combinations, and other non-cash transactions. Consequently such a situation tends to significantly limit compliance with applicable standards in measurement and disclosure of financial information.

69. In the general purpose financial statements of banks, loan loss provisioning is mainly based on prudential requirements. This is common in many other jurisdictions. Banks generally calculate impairment in the unsecured portion of loans and receivables on the basis of a provisioning matrix approved by the CBRC. This calls for a range of fixed provisioning rates for the number of days a loan has been classified as nonperforming, which is one of the factors considered in calculating the loan loss provisions. This methodology may not provide CAS-compliant results. The CAS requires impairment or loan losses to be calculated as the difference between the asset's carrying amount and the present value of the estimated future cash flows (excluding future credit losses that have not been incurred), and discounted at the financial asset's original effective interest rate. However, some Chinese banks present a comparative picture (without reconciliation) showing the impact of applicable CAS and CBRC requirements on reported earnings with regard to loan loss provisioning. The CBRC is aware of these differences and will look to resolve this matter in the future.

70. The methodology to discount technical provisions for pending claims departs from internationally accepted principles. Insurance companies are required to take into consideration CIRC-issued Rule No. 14, *Preparation and Submission of Insurance Company Solvency Report: Insurance Groups and its Practice Guide*. Insurance companies need to comply with CIRC-issued regulations regarding the measurement of technical reserves, which are formulaic and differ from the measurement principle that would apply under CAS. Under this approach, insurance companies are required to discount provisions for pending claims only when they are expected to be paid in 4 years or more. Determining whether a claim will be settled in three years (and does not have to be discounted) or five years (and should be discounted) may be very arbitrary (e.g., in case of claims related to low frequency risks and claims subject to settlements or court rulings). More importantly, an insurance actuary generally evaluates the expected timing for all claim settlements and determines whether discounting is required or not. Reference to an arbitrary cut-off timeframe does not conform to internationally accepted practices.

71. The ASBE was mandatorily applied for the first time in the preparation of financial statements of the 1,570 listed companies as of January 1, 2007. The MOF, with

collaboration of the relevant regulatory agencies, provided guidance and supervision mechanisms for supporting implementation of ASBE in the listed companies. In order to provide a picture of the application of ASBE in listed companies, the Accounting Regulatory Department of the MOF has prepared and published a research report entitled *Analysis of the Implementation of New Accounting Standards in Listed Chinese Companies in 2007*. Again in 2008, a similar study report was published by the MOF Accounting Regulatory Department. These reports depict a picture of continuing and smooth implementation of ASBE.

72. Many companies' financial statements have shown a high degree of compliance with applicable accounting standards and reporting requirements. However, ROSC team identified noncompliance in some financial statements. The ROSC team reviewed 38 listed companies' financial statements with a focus on issues relating to presentation and disclosures. These 38 sets of financial statements cover the financial statements audited by various categories—top, middle, and bottom—of MOF- and CSRC-approved accounting firms. Some examples of noncompliance in the reviewed financial statements are as follows:

- Insufficient disclosure of information in the notes to the financial statements with regard to content and process of specific transactions. For instance, there are inadequate disclosures regarding risks associated to financial instruments, determination of fair value, etc.
- Misclassification of leases (treating finance lease as operating lease). This misclassification improves the liability side of the balance sheet and creates more favorable borrowing capacity.
- Inadequate disclosures in the area of debt restructuring with shareholders and subsidiaries.
- Inadequate disclosure as to the basis for determining business combination.
- Inadequate or no disclosure as to whether actuarial or any other forms of valuation had been made to quantify outstanding liabilities for post-employment benefits.
- Inadequate segment reporting as to geographical areas, product lines, and elements of the balance sheet.
- Classification of restricted equities as available-for-sale financial assets, which should have been accounted for as long-term equity investments in accordance with the applicable Chinese Accounting Standards.

IV. AUDITING STANDARDS AS DESIGNED AND PRACTICED

73. In general, level of compliance with applicable auditing standards varies greatly across accounting firms. To assess actual auditing practices, the ROSC team interviewed practicing auditors and leaders of the audit profession. Discussions were held with the partners representing large and medium-size accounting firms. It appeared that auditors of large accounting firms generally tend to follow auditing standards more efficiently than the small and medium-size practices. Nevertheless, there were instances where some of these larger firms apparently could not ensure a proper quality audit. However, smaller accounting firms

find it difficult to bear the cost of implementing auditing standards in an adequate fashion. Application of CSA requires an auditor to make an assessment of risk and internal controls, leading to an audit strategy and plan that encompasses systems, transactions, and balance testing, which enable the auditor to gain adequate audit evidence for expressing opinion on the financial statements. The large and medium-size accounting firms often have better trained staff and access to updated audit practice manuals. However, smaller accounting firms struggle to keep up to date with latest standards and may have no or limited access to high-quality audit methodology, which has been designed to comply with applicable standards. The ROSC team observed that some cases of noncompliance with CAS detected through the ROSC review of audited financial statements were not revealed in the corresponding auditors' reports. Various stakeholders suggested that improved audit supervision by the audit partners, instead of relying significantly on the trainee students, would improve the application of auditing standards.¹⁹

74. The quality of corporate financial reporting will benefit from further improvements in actual auditing practices. Some major financial scandals in different parts of the world in the early 1990s exposed publicly the ethical-and quality-related problems that existed among the accounting firms for some time, resulting in investors' loss of confidence in the audited financial statements.²⁰ Institutional reforms and other measures have been undertaken to enhance the quality of financial reporting, but there is still room for improvement.²¹ The following examples of weaknesses of the audit practices tend to affect the quality of auditing in China:

- Audit risk and audit materiality are not determined in accordance with the standard and not adequately considered when conducting the audit.
- Documentation practices are not adequate to provide audit evidence to support the audit opinion, mostly in the audit of small and medium-size enterprises.
- Meaningful analytical procedures are not always undertaken along with tests of control and substantive procedures.
- The small and medium-size accounting firms, due to lack of capacity, face difficulties in quality control requirements. Second partner peer reviews are in many cases not done in these firms.
- Auditors sometimes find it difficult to obtain audit evidence and so rely on management representations, particularly for fair values, impairment of assets, related party transactions, segment information, and contingent liabilities.

¹⁹ From discussions by the ROSC team with corporate accountants, it was revealed that due to high turnover of staff in accounting firms, in many cases the junior audit staffs lack adequate training before conducting audit work.

²⁰ Xia, J. Z, Y. Zhang, and Z. Xie, "The Making of Independent Audit Standards in China," *Accounting Horizons*, Vol. 14, No. 1, pp. 69-89, 2000.

²¹ One such measure was the "Rectification Campaign." China initiated this campaign between 1997 and 1999 in order to standardize and raise the quality of accounting and auditing practices. The campaign had on-site inspection of accounting firms; and almost 12,700 individual CPAs were either forced to withdraw from the profession or were disciplined. Few practicing firms had their licenses cancelled for noncompliance with applicable standards and norms.

- Although the CSA on auditor’s report is fully comparable with ISA 700, *The Independent Auditor’s Report on General Purpose Financial Statements*, Chinese audit reports tend to provide less detail on audit qualifications and explanation paragraph.

V. PERCEPTIONS ON THE QUALITY OF FINANCIAL REPORTING

75. In general terms, users of financial statements in China appear to be relatively satisfied with the quality of the financial reporting by listed companies. Interviews with representatives of banks, credit rating agencies, and other stakeholders revealed a consensus that financial information provided by the listed entities, including listed banks and insurance companies meet their needs and expectations. This is broadly attributed to the improved quality in application of CAS in the publicly traded corporate sector. However, many expressed concern about the financial reporting of other enterprises.

76. **Some stakeholders, interviewed by the ROSC team, perceive that the companies, audited by the large accounting firms have high-quality financial information.** The perception is that, a high degree of reliance is placed on the financial statements that are audited by large accounting firms. Some other stakeholders viewed that an audit does not add value but is only a requirement for the company to win a contract or to obtain a bank loan.

77. **The corporate financial reporting quality is not similar in all parts of China.** In less-developed areas of the country, the preparers and auditors of financial statements are relatively weak to properly handle complex accounting and auditing issues. Also, the structure of accountancy profession in remote areas is not adequately developed. For all these reasons, the quality of corporate financial statements varies in different parts of the country.

VI. POLICY RECOMMENDATIONS

78. The main purpose of this section in the ROSC is to offer suggestions to the Government of the Peoples’ Republic of China for further strengthening its private sector’s accounting and auditing practices and in enhancing financial transparency in the corporate sector. The principle-based policy recommendations arising from the assessment of existing practices will be discussed during a workshop with the Government and in-country stakeholders.

79. **Insofar as the recommendations would support some of the key development objectives set by the Government, a wide range of country stakeholders would benefit from them. These stakeholders include the following:**

- *The financial community, especially pension funds, investment funds, and banks* since increased accuracy and reliability of the financial information could enhance their ability to make informed investments and loans and could lead to broadening pension funds’ possibilities of investing.
- *Small and medium-size enterprises and large non-registered enterprises*, which could gain easier and cheaper access to capital. Making available more complete and accurate financial statements to investors and lenders will allow them to place greater

reliance on those statements, which in turn will contribute to diminishing the perceived or real risk related to these investors and lenders. Ultimately, the improved perception should lead to reducing investing and lending premium, reducing financing costs, and improving development prospects on small and medium-size enterprises.

- *Employees of the private sector*, who have an important stake in their company's success and are entitled to receive accurate information on which to judge the impacts and soundness of management decisions. Also, as future retirees they would be the ultimate beneficiaries of improved private pension fund investments.
- *The public sector* – since taxes on corporate profits are based on accounting records, reinforcing accounting and auditing practices in the corporate sector would support the Government's efforts to limit tax evasion and increase its revenues.
- *The accounting profession* – since increased visibility and public confidence arising from the delivery of high-quality professional services would elevate the image of the profession in the minds of the broader business community and its ability to attract high-quality graduates.

80. **The ROSC A&A recommendations are interrelated and mutually supportive and require a holistic approach for implementation.** The ROSC team believes that the champion role played by MOF has been critical for the past success and advises that this role continues with the support from the multi-disciplinary steering committee. The members of the steering committee should advise policymakers on how to implement the ROSC A&A follow-up country action plan for further improvement of the corporate financial reporting regime.

A. Statutory Framework

81. **With regard to statutory framework, the following actions for underpinning the corporate accounting, auditing, and financial reporting practices are recommended through issuance of legal pronouncements:**

- Require legal entity and/or consolidated financial statements to be audited only when there is a public interest for such an audit irrespective of entity's legal form. In general terms, public interest should include listed companies, banks, insurance companies, investment funds, pension funds, and other large entities, including state-owned enterprises of certain size (which may be measured by the amount of revenue it generates or assets it owns, and/or by its number of employees).
- Require public interest entities (not only listed companies as it now stands) to make audited financial statements, including notes to the financial statements, readily available to the public.
- Make arrangements so that the financial statements of banks, insurance companies, and similar financial institutions, under the regulatory purview of CBRC and CIRC, will be audited by the MOF/CSRC-approved auditors.

- Set eligibility criteria as to who can provide training to the aspiring professional accountants.

B. Institutional Capacity Building

82. With regard to strengthening key institutions in the field of corporate accounting and reporting, the following recommendations should be considered:

- The MOF should continue its efforts for maintaining highly skilled workforce to ensure high-quality corporate financial reporting in China.
- The CSRC should engage additional professionally qualified and experienced accountants and train the existing staff for further enhancing the effectiveness of the reviews of financial statements and audit practices.²²
- The CBRC and CIRC should develop a core group, imparting them additional training to identify accounting and auditing infractions in the financial statements of banks and insurance companies.
- The CBRC should align the banking norms on loan loss provisioning with applicable standards and Basel Committee’s recommendations. In this regard, it should undertake a comprehensive study and cover the impacts for banks in terms of (a) amount of provisions, (b) information system supporting the monitoring and accounting of loans, (c) capacity-building efforts required for banks to be able to apply a methodology consistent with accounting standards and Basel Committee’s principles.
- The CICPA should involve more qualified personnel, both internal and external, for carrying out the audit practice review.
- Accounting firms, in particular small and medium-size practices, should have access to updated publications on IFRS and ISA with the support of CICPA. The IFAC *Guide to Using International Standards on Auditing in the Audits of Small and Medium-Size Entities* should be adopted and introduced to local practitioners.

C. Monitoring and Enforcement

83. With regard to improvement of monitoring and enforcement of applicable accounting and auditing standards, the following recommendations should be considered:

- Auditors should supplement capacities of CBRC and CIRC by acting as whistle-blowers by bringing the infractions of applicable standards to the attention of these statutory regulators. Since the financial sector’s vulnerabilities can have quick multiplier effects, appropriate advanced warnings by auditors would help to make the financial sector supervision more efficient and effective. Added to this benefit, there

²² According to IFAC, a professionally qualified accountant is an individual who is a member of an IFAC member body.

could be a synergy between the requirements of prudential regulations and those for the general purpose financial reporting.

- An awareness program should be implemented to improve the degree of compliance with the financial reporting requirements. The related regulatory bodies should continue their efforts for motivating the top management of corporate entities to comply with the accounting and financial reporting standards. Through workshops, top management should be briefed on their responsibilities regarding compliance with standards, and related enforcement policies. New dimensions of regulatory regimes affecting accounting and auditing, and the role of transparent financial reporting in financial and private sector development could also be presented. Moreover, an outreach program could be introduced for financial executives and accounting staff of business enterprises, in different parts of the country, to disseminate knowledge on current developments in accounting and financial reporting standards and practices.

D. Professional Education and Training

84. For enhancing academic and professional education and training, the following recommendations should be considered:

- University-level accounting curricula should be reviewed to ensure a consistent approach is followed in China's universities. Particular focus should be given to include practical application of accounting and auditing standards and improve communication skills and professional judgment, together with case studies to best prepares accountants (rather than bookkeepers) for careers in the corporate sector.
- The staff of the regulatory agencies should have further exposure to practical dimensions of accounting and auditing requirements as per international good practices. Furthermore, they should undertake industry-specific training to update their skills.
- Accountants in state-owned enterprises should be encouraged and persuaded to enroll in retooling programs; and companies should also take similar approach to support employee training and study toward professional accountancy qualification.
- The MOF should develop further guidance on how to arrange delivery of high-quality training programs on practical implementation aspects of accounting and auditing standards and code of ethics for professional accountants. In this regard, MOF should work in collaboration with NAI and CICPA.
- The CICPA should update its practical training requirement of aspiring professional accountants. Also, the CICPA should institute a sound mechanism to ensure the quality of the practical training.
- The MOF and CICPA should reinforce the importance of continuing professional development in order to ensure that members are fulfilling their requirement to upgrade professional knowledge. There is a clear need for improvement in the content, structure, and delivery of the CPD program.

- Participants in the financial reporting process should be encouraged to gain education and training for discharging their professional responsibilities effectively. This covers corporate accountants, regulators, auditors, and taxation officers. The challenge for training and educating the existing and newly qualified accountants and auditors is to impart the core skills and concepts related to private sector accounting and auditing, including principle-based accounting standards, modern auditing standards and techniques, managerial accountability toward shareholders and other stakeholders, and advanced corporate governance.

E. Implementation Priority

85. The implementation of policy recommendations should be prioritized in the following order:

(a) Issue legal pronouncements:

- Make the CAS mandatory only for the public interest and rest of the entities to comply with simplified accounting and corporate financial reporting requirements,
- Require not only the listed companies, but all financial market institutions, to get their financial statements audited by the MOF/CSRC-approved auditors, and
- Require all public interest entities to make their audited financial statements publicly available.

(b) Strengthen current audit practice review arrangements by MOF, CICPA, and CSRC through recruiting more technically qualified people who have the experience of implementing accounting and audit standards.

(c) Revise the accounting curriculum of the institutions of higher learning, focusing on the practical application of CAS and CSA and recruiting adequate number of academics to teach the practical application of standards.

APPENDIX

Roadmap for Continuing and Full Convergence of the Chinese Accounting Standards for Business Enterprises with the International Financial Reporting Standards (Exposure Draft)

Ministry of Finance, People's Republic of China, September 2, 2009

International convergence is an inevitable choice for nations to grow their economy and economic globalization. Since 2005, China has developed the ASBEs that are substantially converged with the IFRSs and made a smooth transition from the old system to the new standards thanks to an effective and stable implementation of the new standards, thus taking the lead among Asian countries and emerging market economies. After the international financial crisis broke out, the G20 summits and the Financial Stability Board (FSB) initiated to establish a single set of high-quality global accounting standards, raising the issue to an unprecedented high level. The International Accounting Standards Board (IASB) has taken a series of important actions to accelerate the international convergence of accounting standards of various jurisdictions. In this context, it's imperative to respond actively to the changed international landscape.

I. A roadmap for continuing and full convergence of the ASBEs with the IFRSs developed and released in response to G20/FSB recommendations

In response to the international financial crisis, the G20 summit in Washington on November 15, 2008 produced a profound analysis and summary of root causes of the crisis, putting forward action plans including improving the IASB governance and establishing a single set of high-quality global accounting standards. The G20 summit in London in April 2009 required proactive collaboration from member countries. From June 26 to 27, 2009, FSB, restructured from FSF, held its inaugural meeting in Basel, Switzerland, deciding to establish a steering committee and three standing committees responsible for vulnerability assessment, supervisory and regulatory cooperation and standards implementation. The Ministry of Finance of China (MOF), the People's Bank of China (PBOC), and the China Banking Regulatory Commission (CBRC) are members of the FSB. One task of its Standards Implementation Committee is to promote international convergence of national accounting standards.

Based on the recommendations of the G20/FSB, the IASB spared no effort to study the problems unveiled by this financial crisis and look for how to improve accounting standards to help regulators solve these problems. The IASB:

- (1) In December 2008, established the Financial Crisis Advisory Group (FCAG), which issued a report in July 2009 with detailed proposals to improve financial reporting in response to the crisis;
- (2) On May 28, 2009, issued an exposure draft *Fair Value Measurement*, which will be finalized in the first half of 2010.
- (3) On July 14, 2009, issued an exposure draft *Classification and Measurement of Financial Instruments* as the result of the first phase of the comprehensive project of reducing the complexity of accounting standards for financial instruments; and plan to issue an exposure draft of the second phase in October addressing issues concerning pro-cyclicality and loans provisioning to simplify accounting for impairments of financial

assets, and another exposure draft for the third phase to be issued in December to simplify hedge accounting.

- (4) Proposed to cooperate with the FSB to establish a formal dialogue for financial reporting of financial institutions to enhance the dialogue mechanism with all stakeholders.

FSB will monitor progress in implementing key international regulatory standards, including the IFRSs, by member countries. The matter of accounting standards has grown into a priority task with public accountability and government background, not only for the accounting profession. In response to the G20/FSB recommendations, we will track and participate in major projects of the IASB in light of China's actual situation, release the roadmap for continuing and full convergence of the ASBE with the IFRSs, and make contributions to a single set of high-quality global accounting standards.

II. The ASBE is substantially converged with the IFRSs, laying a solid foundation for the continuing and full convergence

In the whole year of 2005, the MOF focused on finalizing the IFRS-converged ASBE (including a Basic Standard and 38 Specific Standards). During this period, IASB sent several missions to work with the Accounting Regulatory Department of the MOF. On November 8, 2005 the IASB and the China Accounting Standards Committee (CASC) signed a joint statement. The statement indicated that China issued exposure drafts of the Basic Standard and Specific Standards in the past year and the system of ASBE was being developed with a view to achieving convergence of those standards with the IFRSs. Both sides acknowledged that the two sets of standards had differences on a limited number of matters, including the reversal of impairment losses and disclosures of related party relationships and transactions. The two sides agreed to continue to push forward the related work to eliminate these differences. In addition, IASB identified a number of accounting issues in China because of its unique circumstances and environment, including the disclosure of related party transactions, fair value measurements and business combinations between entities under common control, where China could be very helpful to the IASB in developing high-quality IFRSs solutions.

The MOF officially promulgated the ASBE system on February 15, 2006. Sir David Tweedie, Chairman of the IASB, attended the releasing conference and highly commended the new system. The ASBE has been effective to all listed companies from January 1, 2007. The MOF worked with the China Securities Regulatory Commission (CSRC) and other agencies to enhance guidance over and dynamic monitoring of listed companies in their implementation of the accounting standards. As a result of joint efforts from all related parties, the ASBE has been well tested and proven in practice. The Accounting Regulatory Department of the MOF took a "day-to-day tracking and one-by-one analyzing" approach for an in-depth analysis of the financial reporting information disclosed by each listed company, producing an analysis report on the effective implementation of the accounting standards by Chinese listed companies in 2007, the English version of which was timely sent to the IASB, the World Bank and the European Commission. In the first half of 2009, the Accounting Regulatory Department of the MOF adopted the same approach to further track the implementation of ASBE by listed companies in 2008, producing a similar report with the conclusion that listed companies in China maintained their effective and smooth implementation of ASBE in the year covered.

In May 2008, IASB experts conducted a field study of the ASBE implementation in Chinese listed companies, holding meetings with listed companies, accounting firms and investment banks and funds respectively and further confirmed the conclusion of the smooth and effective implementation of the system. The World Bank experts also appreciated the effective implementation of the ASBE after their study tour, saying that the *China Accounting Reform and Development* project was one of the Bank's most successful technical assistance projects. According to the assessment by the

Internal Market & Services DG, EU, the ASBE performed well in China. On December 12, 2008 the EU issued a regulation on the equivalence of third country accounting standards, among other things allowing Chinese enterprises listed or to be listed on the EU regulated markets to file financial statements prepared under the ASBE for the transitional period from 2009 to the end of 2011. The CASC and the Hong Kong Institute of Certified Public Accountants (HKICPA) announced the equivalence of accounting standards of the mainland of China and Hong Kong (Hong Kong Financial Reporting Standards are equivalent to the IFRSs) by signing a joint declaration on equivalence on December 6, 2007, the culmination of their one-year comparative study of the two sets of standards. This can facilitate easier access to Hong Kong stock market and lower costs for mainland enterprises, serving the common development of capital markets on both sides.

The aforementioned facts point to the convergence of the ASBE with the IFRSs, and its effective implementation by listed companies in China, widely recognized both home and abroad. On this basis, China, aware of the latest international changes and answering to the calls of the G20 summits and the FSB, shall focus on the continuing and full convergence of its accounting standards to make its contribution to the building of a single set of high-quality global standards.

III. Schedule and main items of the roadmap for continuing and full convergence of the ASBE with the IFRSs

It is a major systematic project to build a single set of high-quality global accounting standards. China fully recognizes and appreciates the unremitting efforts made by the IASB over the years and the many results thus achieved, especially the countermeasures it took in response to the crisis as recommended by the G20 and the FSB, and will continue to support the IASB in its endeavor. Meanwhile, we believe that as emerging market economies have their own legal, economic and cultural specificities, establishing high-quality global accounting standards should be based not only on economic conditions in developed countries but also on the full account of the circumstances in emerging market economies.

- A. We will actively participate in the IASB agenda items on which major revisions are planned to help with better-informed development of a single set of high-quality global accounting standards about the circumstances in emerging market economies.**
- The CASC and the IASB have jointly set up a working mechanism for the continuing convergence, under which they hold at least two technical meetings a year for in-depth analysis of the implementation of the accounting standards and the future development of the IFRSs. The mechanism proves highly pragmatic and effective. As part of its continuing and full convergence program, China will be an active participant in IASB's revisions of the financial instruments, fair value measurement and financial statement presentation standards in response to the international financial crisis. The MOF has also proactively initiated to set up the Asian-Oceanian Standard Setters Group (AOSSG) with the same hope that the IASB will give as much as possible consideration to the economic realities in China and other emerging market economies.

China supports the IASB to simplify the *IAS 39 Financial Instruments: Recognition and Measurement*. According to the exposure draft of the first phase, *Classification and Measurement of Financial Instruments*, which was issued on July 14, financial instruments are proposed to be classified into two categories, i.e., measured at amortized cost and at fair value. While recognizing the value of the "two category" solution, China, as an emerging economy, is concerned about the expanded scope of fair value measurement. China believes that for financial assets/liabilities with basic loan features and managed on a contractual yield basis, amortized cost measurement will provide more useful information.

China agrees to introduce other comprehensive income into financial statements with the reservation that substantial changes to the internal structure and presentation items of the current financial statements may not be appropriate. Since the current structure and items of presentation are well used in practice, there appears no need of major structural changes to them. Besides, there may be legal barriers to significant revisions of the presentation of statements.

- B. We will make an effort to eliminate the few differences existing between the ASBE and the IFRSs.** After more than four years of discussion, IASB officially approved the revision to *IAS24 Related Party Disclosures* on August 4, 2009. The revised IAS24 considers China's situation and removes the difference between the ASBE and the IFRSs on this matter. As the accounting for assets revaluation in corporate restructuring is unique to China, the MOF has turned to the IASB for a solution for several times. On August 26, 2009, the IASB in its annual improvements project decided to make amendments to the *IFRS 1 First-time Adoption of International Financial Reporting Standards*, with the commitment to make corresponding revision. On that, the IASB should be credited with its pragmatic and effective efforts to accommodate the specificities of emerging economies like China.

China's business combination standard spells out the accounting for business combinations between entities both under common control and not under common control. While IFRSs provide for the accounting for combinations not involving entities under common control, namely the acquisition method, accounting for business combinations involving entities under common control remains a vacancy. It is indicated in the Joint Statement 2005 between the CASC and the IASB that the provisions and practice of the ASBE in this respect will provide the IFRSs with a useful reference. We expect IASB to add this project into its agenda as soon as possible.

According to the IFRSs, enterprises are permitted to reverse impairments of non-current assets, such as fixed assets, intangible assets, etc., recognized previously and include them in profit or loss. However, according to the China's assets impairment standard, such asset impairment losses are not allowed to be reversed once recognized. IASB expressed its understanding of China's rule and asked us to follow the progress of the convergence project of FASB and IASB on assets impairment to jointly study and resolve this problem.

- C. Schedule for the continuing and full convergence of the ASBE with the IFRSs.** The IASB plans to complete major projects like financial instruments, revenue recognition and financial statements presentation by 2011. Therefore 2011 is also the target year for the continuing and full convergence program of the ASBE, making 2010-2011 a critical period for the convergence. The MOF plans to kick off the overhaul to its ASBE system in 2010 and finish by 2011. All large and medium-sized enterprises will be required to use the revised standards as of 2012. The revised ASBE system will still consist of three parts, i.e., the Basic Standard, Specific Standards and Implementation Guidance. While the Basic Standard remains unchanged, the Specific Standards will be revised and complemented. The existing Implementation Guidance will be incorporated in related Specific Standards and the current Explanatory Guidance for the ASBE will be renamed the Implementation Guidance with enhanced contents and illustrative examples for enterprises to better understand and implement the accounting standards system after the convergence process. Beginning from 2011, the ASBE and the IFRSs will embrace a relatively stable period during which emerging transactions or events in practice will be addressed through the continuing and full convergence mechanism.