Accounting and reporting
Observations

1. There are currently two accounting regulation systems in China, ASBE\(^1\) and CAS 2006.\(^2\) CAS 2006 is substantively converged with IFRS,\(^3\) and ultimately, will be adopted by all companies (except for small enterprises that elect to adopt ASBE).

2. Even if the functional currency is not renminbi, your company in China will still need to present one set of financial statements in renminbi for statutory purposes.

3. Tax regulations require that companies make necessary adjustments to their accounting profits to arrive at their taxable profits. With the issuance of CAS 2006, there would be even more differences between accounting books and tax returns.

Recommendations

1. Make sure you have at least a general understanding of the differences among ASBE, CAS 2006 and IFRS, and their different impacts on the financial positions and results. Ensure your companies in China select an appropriate accounting regulation system to adopt.

2. Pay attention to the accounting year in China which must be from 1 January to 31 December and may not be the same as your group’s reporting packages.

3. Ensure your local accounting profit is appropriately adjusted to the taxable profit in the tax return in accordance with the tax regulations.

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1. The Accounting System for Business Enterprises, 18 specific accounting standards and other related accounting regulations
3. The International Financial Reporting Standards
Introduction to books and records

The Accounting Law defines the roles of the governmental departments on accounting matters and specifies the fundamental requirements of accounting practice, accounting procedures and accounting supervision. The Accounting Law empowers the department of finance under the State Council, i.e., the Ministry of Finance (MoF), to administer nationwide accounting matters, including the promulgation of uniform accounting regulations/accounting standards that must be complied with throughout the country by all the applicable companies.

In China, your companies are required to maintain accounting records and prepare annual financial statements in accordance with the accounting regulations/accounting standards issued by MoF. The Accounting Law stipulates that companies must keep three kinds of primary accounting records: journals, a general ledger and sub-ledgers, as well as appropriate supplementary memorandum records. Computerised accounting systems, if used, can be regarded as the company’s accounting records.

All accounting documents, books and financial statements prepared by a company must be written in Chinese. They can also be written concurrently in a foreign language. Companies are required to keep accounting records, financial statements and supplementary memoranda for at least 15 years.

Two accounting regulation systems

At the moment, there are two parallel accounting regulation systems, both issued by MoF:

1. The Accounting System for Business Enterprises, 16 specific accounting standards and other related accounting regulations (ASBE), and

ASBE

ASBE is effective from 1 January 2001 and is applicable to all types of companies, until certain types of companies are required to, or those companies have volunteered to adopt CAS 2006 from 1 January 2007 or thereafter, e.g., all listed companies are required to adopt CAS 2006 from 1 January 2007. ASBE comprises the Accounting System for Business Enterprises, 16 specific accounting standards and other related accounting regulations. The Accounting System for Business Enterprises sets out the accounting treatments for major line items in financial statements, in the order of assets, liabilities, equity, income, expenses etc.

The 16 specific accounting standards include:
1. Inventories
2. Fixed assets
3. Intangible assets
4. Investments
5. Borrowing costs
6. Debt restructurings
7. Revenue
8. Construction contracts
9. Leases
10. Exchange of non-monetary assets
11. Contingencies
12. Accounting policies, changes of accounting estimates and correction of errors
13. Cash flow statements
14. Events after the balance sheet date
15. Interim financial reporting
16. Related-party disclosures
However, these 16 specific accounting standards themselves do not form a comprehensive basis of accounting. They serve only as additional/supplementary accounting requirements/guidance to the Accounting System for Business Enterprises. Some of them are only applicable to the joint-stock companies.

Although the recognition and measurement principles under ASBE are largely in line with those under International Financial Reporting Standards (IFRS), there are major differences in a number of areas. Here are some examples:

- Fair value measurement is not allowed
- Recognition of deferred tax is not mandatory
- The concepts of financial instruments and share-based payments are not introduced
- Preparation of consolidated financial statements is not mandatory for non-listed companies

**CAS 2006**

CAS 2006 was issued by MoF on 15 February 2006. It forms a comprehensive basis of accounting and is seen as substantively converged with the IFRS. CAS 2006 is effective from 1 January 2007 for all listed companies and becomes effective for companies such as financial institutions and large and medium-size state-owned enterprises in the following years as required by the various authorities.

In many provinces and cities, certain other types of companies may also have already been required by the local finance authorities to adopt CAS 2006. Eventually, CAS 2006 will be the only basis of financial reporting for all types of business enterprises, except those small enterprises that are qualified to adopt the “Accounting Standards for Small Enterprises” (see also Accounting Standards for Small Enterprises later in this chapter). For those companies that have not yet adopted CAS 2006 (mainly non-listed foreign investment enterprises and privately owned enterprises), the mandatory adoption date is yet to be determined by MoF, though early adoption is allowed.

As of April 2012, CAS 2006 comprises one basic standard, 38 specific standards, application guidance for 32 specific standards, four interpretations and four yearly issued annual report guidance; that is, from 2008 to 2011.

In addition, the officials of the Accounting Regulatory Department of the MoF, who are responsible for drafting CAS 2006, have formed a team to compile a guidebook to CAS 2006, which is equivalent to the “implementation guidance” for IFRS. This guidebook is one of the major sources for further guidance and interpretation on the implementation of CAS 2006. The most updated book is the “Implementation Guidance 2010,” published at the end of 2010.

CAS 2006 is more converged with IFRS than ASBE, particularly in the areas of:

- Deferred taxation
- Business combinations under non-common control
- Share-based payments
- Financial instruments
- Assessment for asset impairment

While CAS 2006 doesn’t reflect a literal translation of IFRS, it essentially matches all of the accounting principles under IFRS. In addition, it interprets accounting treatments for certain types of transactions that often take place within the China environment (e.g., combinations of companies under common control), and certain specific industry accounting issues, such as the extraction of oil and natural gas.

There are still a small number of differences between CAS 2006 and IFRS. For example, the reversal of impairment loss already provided for on non-current non-financial assets is not allowed.

For a comparison of the index of CAS 2006 and IFRS, please see the Appendices.
A summary of accounting requirements

The following discussion on the accounting regulation systems in China are based on the requirements under both ASBE and CAS 2006 (unless specified otherwise).

Financial statements
A complete set of financial statements include:

- A balance sheet
- An income statement (profit and loss account)
- A cash flow statement
- A statement of changes in owners’ equity
- Notes to financial statements

Under ASBE, the statement of changes in owners’ equity is not required. For sample financial statements under CAS 2006, please see the Appendices.

Notes to the financial statements
Notes to the financial statements must include at least the following information:

- Basis of preparation of the financial statements
- Statement of compliance with CAS 2006 (this isn’t required under ASBE)
- Description of significant accounting policies, including the measurement bases for items recognised in the financial statements and the bases for selecting those accounting policies
- Description of the key accounting estimates, including the bases for determining any accounting estimates that may have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next accounting period (not required under ASBE)
- Descriptions of any changes in accounting policies and accounting estimates, and corrections of errors
- Additional descriptions of significant items presented on the face of the balance sheet, income statement, cash flow statement and statement of changes in owners’ equity
- Disclosure of contingencies and commitments, non-adjusting events after the balance sheet date, related-party relationships and transactions

Although CAS 2006 has substantially converged with IFRS, there are additional considerations to be taken during the implementation due to the special circumstances in China. A number of transactions or events under the specific environments in China may result in accounting treatments different from those derived from the principles and description in IFRS. Some of the differences are not explicitly described in the accounting standards.

Baolang Chen, PwC China Assurance Partner
Accounting year and tax year

The accounting year for a company starts on 1 January and ends on 31 December. That is to say, only the calendar year is allowed as the accounting year. And for the purpose of calculating income tax, the calendar year is also the tax year. Companies are required to file their annual income tax returns and statutory audited financial statements to local tax authorities within five months after the end of a tax year.

Companies are also subject to an annual examination by the local industrial and commercial bureau (the authority responsible for administering the registration of companies). During the annual examination process, companies are required to file their statutory audited financial statements together with other annual examination materials before 30 June of the year subsequent to the accounting year.

Recording currency/functional currency

Under Chinese Accounting Law, renminbi (RMB) has to be the recording currency (functional currency) for purposes of bookkeeping and presenting financial statements. Foreign currencies are also permitted as the recording currency if they meet the criteria for determining the recording currency set out in accounting regulations/accounting standards.

Under ASBE, companies in which income and expenses are mainly in currencies other than RMB can choose one of those currencies as their recording currency.

Under CAS 2006, companies can choose the currency of the primary economic environment in which they operate as their recording currency.

However, under both ASBE and CAS 2006, a set of financial statements for statutory purposes must be presented in RMB by translating the financial statements in the recording currency.

To resolve CAS 2006 implementation issues, you need to know the thought process of the standard setters. This requires an accumulation of experience. For those accounting treatments that are not explicitly stated or would not be able to be derived directly from the principles and description in the standards, verbal interpretations from the standards setters might be needed.

Baolang Chen, PwC China Assurance Partner
**Foreign currency translation**

Under ASBE, foreign currency transactions are translated into the recording currency using the spot exchange rate at the date of the transactions or the spot exchange rate at the beginning of the period.

ASBE doesn’t address the distinction between monetary items and non-monetary items. Instead, it has a specific requirement that the period-end balance of each foreign currency account (including foreign currency prepayments and advances from customers – non-monetary items) be translated using the spot rate at period-end.

Under CAS 2006, foreign currency transactions are translated into the recording currency using the spot exchange rate at the date of the transactions or an exchange rate that approximates the actual spot exchange rate on the date of transactions, by applying a systematic and rational method.

CAS 2006 addresses the distinction between monetary items and non-monetary items as follows:

- Foreign currency monetary items are translated using the spot exchange rate at the balance sheet date.
- Foreign currency non-monetary items are measured in terms of historical cost and translated using the spot exchange rate on the date of the transaction.
- Foreign currency non-monetary items are measured at fair value and translated using the spot exchange rate on the date when the fair value was determined.

Note that most foreign-invested enterprises choose to record their books in RMB because China is the economic environment in which they primarily generate and expend cash.

**Financial instruments**

Under ASBE, concepts such as “financial instruments,” “financial assets,” “financial liabilities” and “derivatives” are not introduced.

The following items are stated at cost (for assets, cost less impairment) and fair value measurement is not permitted:

- Receivables (accounts receivable, notes receivable and other receivables etc.)
- Payables (accounts payable, notes payable and other payables etc.)
- Investments (short-term investments and long-term investments etc.)
- Borrowings (short-term borrowings and long-term borrowings etc.)

You also don’t need to account for derivatives until the gains and losses are realised.

CAS 2006 is different. Concepts such as “financial instruments,” “financial assets,” “financial liabilities” and “derivatives” are explicitly and specifically defined.

Financial assets are initially classified as financial assets at fair value through profit or loss, held-to-maturity investments, loans and receivables and available-for-sale financial assets. Financial liabilities are initially classified as financial liabilities at fair value through profit or loss and other financial liabilities.

Under CAS 2006, financial instruments are initially measured at fair value. Except for held-to-maturity investments, loans and receivables and other financial liabilities, which are subsequently measured at amortised cost using the effective-interest-rate method, all other financial instruments are subsequently measured at fair value.

**Accounts receivables**

Under ASBE, accounts receivables are presented at actual amounts net of provision for doubtful debts.

Under CAS 2006, however, accounts receivables (one type of financial asset) are recognised initially at fair value and subsequently measured at amortised cost using the effective-interest method, less provision for impairment. The amount of the provision is the difference between the asset’s carrying amount and the present value of estimated future cash flows, discounted at the initial effective interest rate.

Subsequent recoveries of the amounts previously written down are reversed into profit or loss.

**Inventories**

Inventories are initially measured at cost.

Under ASBE, a company can choose the first-in/first-out method, the last-in/first-out method, the weighted average cost method or the specific identification method to assign the actual cost of inventories.

But under CAS 2006, the last-in/first-out method is not allowed.

At the balance sheet date, inventories are measured at the lower of cost and net realisable value.
**Fixed assets**

Fixed assets are measured initially at cost. The cost of a self-constructed fixed asset is a sum of the expenditures your company needs to incur to bring the asset to working conditions for its intended use.

A company should choose the depreciation method that reflects the pattern that the future economic benefits of that asset are expected to be consumed. The depreciation can be determined using the straight-line method, the units of production method, the double-diminishing balance method or the sum-of-the-digits method.

If there's indication that the fixed assets are impaired, then impairment tests will be carried out. If these tests show the recoverable amount as less than the carrying value, then an impairment loss is recognised and recorded in profit or loss.

Under ASBE, when there's indication that the need for an impairment provision recorded in a prior year no longer exists or has decreased, then the provision for impairment loss is reversed. Under CAS 2006, once an impairment loss is recognised, it should not be reversed in the subsequent periods.

**Intangible assets**

Intangible assets are measured initially at cost and are amortised over a period in which the economic benefits of those assets are expected to be consumed.

Under ASBE, intangible assets with an indefinite useful life are amortised over a period of not more than 10 years. Under CAS 2006, however, an intangible asset with an indefinite useful life is not amortised. CAS 2006 nonetheless requires companies to run annual impairment tests on such assets.

Under ASBE, expenditures on an internal research and development project are recognised in profit or loss for the period in which they are incurred. Under CAS 2006, these expenditures are classified into expenditures in the research phase and expenditures in the development phase. Expenditures in the research phase are recognised in profit or loss for the period in which they are incurred. Expenditures in the development phase are recognised as intangible assets only upon satisfying certain conditions.

Regulations under ASBE and CAS 2006 for impairment tests of intangible assets are similar to fixed assets, except for intangible assets with indefinite useful lives (which under CAS 2006 has to be tested for impairment at least once a year).

Since all lands are owned by the state in China, companies should normally make a lump sum payment to obtain a land-use right for a certain period of time. The land-use right is recognised as an intangible asset and is amortised over its approved land-use period.

**Borrowing costs**

Under ASBE, qualifying assets only include fixed assets and properties under development by real estate development companies. Only borrowing costs incurred on specific borrowings are eligible for capitalisation; borrowing costs on general borrowings are recognised as expenses during the period in which they are incurred.

Under CAS 2006, qualifying assets include fixed assets, investment properties, inventories, costs of construction contract and development expenditures recognised as intangible assets etc. Borrowing costs incurred on both specific borrowings and general borrowings are eligible for capitalisation.

**Share-based payments**

Under ASBE, share-based payments are not accounted for until the date of settlement. If the equity instruments granted are those of the company’s parent or another company within the group, the accounting treatment is not pushed down to the company.

Under CAS 2006, regardless of whose equity instruments are granted (the company, the parent or another company within the group), the company is required to recognise the service received as expenses during the vesting period. You'll have to measure the equity-settled share-based payments at the fair value of the equity instruments granted at the grant date. They cannot be remeasured. Cash-settled share-based payments, however, are measured at the fair value of the liabilities and are remeasured at each balance sheet date and the settlement date, with the changes in fair value recognised in profit or loss.
Revenue recognition

You can only recognise revenue from the sale of goods when:

- The significant risks and rewards of ownership of the goods are transferred to the buyer;
- The company does not keep continuing managerial involvement to the degree usually associated with ownership or effective control over the goods sold; and
- It’s probable the economic benefit associated with the transaction will flow to the company and the amount of revenue and associated costs can be measured reliably.

Revenue arising from the rendering of services is recognised using the “percentage-of-completion method” when:

- The amount of revenue and associated costs arising from the rendering of services can be reliably estimated; and
- It’s probable that the economic benefits associated with the transaction will flow in and the stage of completion of transaction can be reliably measured.

Government grants

Under ASBE, government grants are recognised in profit or loss when they are received, unless a related government document calls for specific accounting treatment (e.g., it may require grants to be recognised directly into equity).

Under CAS 2006, government grants are recognised when they’re received and the company can comply with the conditions attached to the grants. Government grants related to assets are recognised as deferred income, and evenly amortised over the useful lives of the related assets in profit or loss.

Government grants related to income are accounted for as follows:

- Where the grants are to be compensation for related expenses or losses to be incurred in the future, they’re recognised as deferred income, and included in profit or loss over the periods in which the related costs are recognised
- Where the grants are compensation for related expenses or losses already incurred, the grants are recognised immediately in profit or loss for the current period
- Under CAS 2006, government grants are presented as a gross amount as deferred income or non-operating income and are not offset against the carry amount of the relevant assets or the expenses to be compensated.

Deferred income taxes

Under ASBE, either the tax payable method or the income statement-based tax-effect accounting method may be used in accounting for income taxes.

Under CAS 2006, only the balance sheet-based tax-effect accounting method is used in accounting for income taxes.

Owners’ equity

Owners’ equity shown on the balance sheet includes paid-in capital, capital reserves, surplus reserve and undistributed profits.

Paid-in capital is the actual amount of registered capital contributed by the investors in a company in accordance with the company’s articles of association, investment contracts or agreements. The amount of capital contributed by an investor in excess of its share of the registered capital is shown as capital reserves.

For foreign-invested enterprises, surplus reserves include the following:

- Reserve fund: This is a fund appropriated from net profit in accordance with laws and administrative regulations. When approved, the fund can be used to offset accumulated losses or increase registered capital. Wholly owned foreign enterprises need to appropriate a minimum reserve fund that’s 10% of the current year net profit (after offsetting any accumulated loss, if any), unless the cumulated reserve fund appropriated reaches 50% of the registered capital. For other foreign-invested enterprises, the appropriation rate is determined by the board of directors.

- Enterprise expansion fund: This is a fund appropriated from net profit in accordance with laws and administrative regulations for the purpose of the enterprise’s production and development. When approved, the fund can be used to increase registered capital. This fund is not required for wholly owned foreign enterprises. For other foreign-invested enterprises, the appropriation rate is determined by the board of directors.
**Business combination**

Under ASBE, business combination is not specifically addressed.

Under CAS 2006, the purchase method is used for business combination of entities not under common control. While goodwill is not amortised, it is reviewed for impairment at least once a year.

For a business combination of entities under common control, the pooling-of-interests method is used.

**Consolidation (for investments in subsidiaries)**

Under ASBE, the following investee entities are defined as subsidiaries and are consolidated:

- Investee entities over which the parent holds more than 50% (not including 50%) of the registered capital of the investee; or
- Investee entities over which the parent holds 50% or less of the registered capital of the investee, but in substance, has control.

Control is the parent’s ability to govern the financial and operating policies of a subsidiary in order to gain benefits from the latter's activities.

Under CAS 2006, the focus is on the power of control in determining whether a parent/subsidiary relationship exists. A parent includes all subsidiaries within the scope of consolidation, as long as control exists.

Under ASBE, non-listed companies are not required to prepare consolidated financial statements, while there is no such exemption under CAS 2006.

**Consolidation (for investments in joint ventures)**

Joint ventures are companies in which the investor has joint control with the other investor, generally accompanying a shareholding of 50% of the voting rights.

Under ASBE, joint ventures are consolidated using the “proportionate consolidation method.”

Under CAS 2006, investments in joint ventures are accounted for using the “equity method.”

**Consolidation (for investments in associates)**

Associates are companies in which the investor has significant influence but no control, generally accompanying a shareholding of between 20% and 50% of the voting rights. Under both ASBE and CAS 2006, investments in associates are accounted for using the equity method.

**Stand-alone financial statements**

All companies, with or without subsidiaries, are required to prepare stand-alone financial statements (as opposed to consolidated financial statements).

Under ASBE, investments in subsidiaries, joint ventures and associates are all accounted for using the equity method in stand-alone financial statements. Under CAS 2006, investments in subsidiaries are accounted for using the “cost method.” Investments in joint ventures and associates are accounted for using the equity method.

**Cash flow statements**

Your company is required, under ASBE, to prepare cash flow statements using both the direct and indirect method.

Under CAS 2006, cash flow statements are prepared using the direct method. A reconciliation of net profit to the amount of cash flows from operating activities using the indirect method is disclosed in the notes to the financial statements.

**Related-party relationships**

Specific disclosures are required for related-party relationships and transactions.

Under ASBE, if a party has the power to directly or indirectly exercise control, joint control or significant influence over another party, then these parties are in a related-party relationship. If two or more parties are controlled by the same party, then there's also a related-party relationship between the controlled parties.

Under CAS 2006, besides the above-mentioned related-party relationships, if a party is controlled or jointly controlled by its investor, and another party is at least significantly influenced by the same investor, these two parties are also regarded as related parties.

State-owned enterprises are common in China. However, these enterprises are not regarded as related parties merely on the basis that they’re all controlled by the state (unless another related-party relationship exists between them).
**Accounting Standards for Small Enterprises**

The Accounting Standards for Small Enterprises (ASSE), issued by MoF in November 2011, is only applicable to small enterprises that have not yet adopted CAS 2006. It will be effective from 1 January 2013, and early adoption is encouraged. The ASSE’s main objectives are to simplify the bookkeeping of small enterprises and to eliminate the differences between the books and taxes as much as possible.

The criteria for qualifying as a small enterprise, mainly in terms of the size and nature of the enterprises, are set out in a regulation issued jointly by five ministries under the State Council (including MoF and the Ministry of Industry and Information Technology, etc). Moreover, small enterprises that fall into one of the following three categories are not allowed to adopt ASSE:

- Small enterprises that issue publicly-traded shares or bonds
- Small enterprises that are financial institutions or have the nature of financial institutions
- Small enterprises that are the parents or subsidiaries within a consolidation group (For this purpose, the parents or subsidiaries only refer to those companies incorporated within China)

Under ASSE, accounting treatments are more in line with tax laws and regulations. For example, assets are stated at cost and provision for impairment is not allowed.

You would normally have to make necessary adjustments to your company’s accounting profit in accordance with tax regulations in order to arrive at its taxable profit. This is inevitable, and with the issuance of CAS 2006, differences between the accounting books and tax returns have increased. For the purpose of calculating enterprise income tax, accounting regulations/accounting standards are significantly different from tax regulations.

For example:

- If companies make provisions for impairment of assets without first obtaining approval from the tax authorities, the amounts of the provisions must be added back to the accounting profit when determining taxable profit.
- The non-straight-line depreciation method is not allowed, except under certain specific circumstances (such as fixed assets suffering from severe corrosion over the years). In addition, the tax authorities have set minimum depreciation periods for certain assets.
- Unrealised gains and losses arising from changes in fair value (such as fair value changes of derivatives) are not tax payable/deductible.
*Audit requirements and practices*

**Audited financial statements**

Foreign-invested enterprises are required to engage a Chinese-registered certified public accounting (CPA) firm (which includes approved Sino-foreign joint venture CPA firms) to audit their statutory annual financial statements. It is generally the duty of the board of directors of a foreign-invested enterprise to appoint the auditor.

Audits are required under the company laws, financial reporting regulations and income tax laws in China, and audited financial statements should be filed with the tax authorities, together with the annual income tax returns. Foreign-invested enterprises are required to provide auditors with all the enterprise's documents, books and reports. The financial statements to be submitted for an annual audit include the balance sheet, income statement, statement of changes in owners’ equity, statement of cash flows and relevant supporting notes.

Audited financial statements must be submitted to a number of government authorities, mainly:

- The local offices of the State Administration of Industry and Commerce
- The State Administration of Taxation
- The local Finance Bureau
- The State Administration of Foreign Exchange

Audited financial statements must be submitted to the relevant authorities within four to six months of year-end, depending on local government requirements.

**Accounting profession**

The national regulatory authority for China's CPA profession is the Ministry of Finance. The Chinese Institute of Certified Public Accountants (CICPA), which was established in late 1988, is the organisation that regulates the profession. In addition to licensing certified public accountants, the CICPA's main functions are:

- To ensure that all CPAs perform their duties in accordance with the relevant laws and regulations
- To promote the development of the profession
- To enhance the professionalism of its members and maintain their legitimate professional rights
- To promote the exchange of work experiences and business information
- To improve the association between Chinese CPAs and their foreign counterparts

The registration of CPAs in China was discontinued in 1952 and resumed again in 1980, resulting in a shortage of experienced and qualified professionals and a general unfamiliarity with international practices. However, in recent years, with an increasing emphasis on accounting education and the encouragement of more people to enter the profession, this situation is improving rapidly.

Although approved joint ventures and member CPA firms are the only foreign-owned firms able to perform statutory audits in China, other foreign CPA firms may be engaged to perform certain audit and accounting work for accounting and management control purposes. This includes developing accounting and internal control systems, training local accounting personnel, reviewing specific financial information for accuracy and reliability, and performing full or limited-scope audits to meet the audit requirements of the foreign partner's parent company. If requested by the foreign partner and with the consent of the Chinese partner, in certain cases, they may also perform joint audits with the local CPA firms to ensure that the audits will satisfy both the Chinese and the foreign partner's home country auditing standards and requirements.
Auditing standards

The audit requirements for enterprises are contained in the Accounting Law, Company Law, and in the Regulations on Accounting and Financial Reporting.

The requirement for annual audits is also contained in the Enterprise Income Tax Law, which came into effect in January 2008.

Rules on the audits of financial statements by certified public accountants were formulated by the CICPA and first published in December 1988. They were subsequently updated in December 1995 before the CICPA issued new auditing standards (in 2006) that were substantially converged with International Standards on Auditing; these standards came into effect from 1 January 2007. In November 2010, CICPA issued the revised China Standards on Auditing (CSA 2010, also Clarity CSAs) to keep continuous convergence with Clarity International Standards on Auditing; the Clarity CSAs came into effect on 1 January 2012.

A typical unqualified audit report would read as follows:

“We have audited the accompanying financial statements of XYZ Company, which comprise the balance sheet as at [date], and the income statement, statement of changes in owners’ equity and cash flow statement for the year then ended, and the notes to these financial statements.

Management’s responsibility for the financial statements

“Management of XYZ Company is responsible for the preparation and fair presentation of these financial statements in accordance with the requirements of Accounting Standards for Business Enterprises, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.”

An unqualified opinion would typically be as follows:

“In our opinion, the financial statements present fairly, in all material respects, the financial position of ABC Company as at [date], and its financial performance and its cash flows for the year then ended in accordance with the requirements of Accounting Standards for Business Enterprises.”