

UNDERSTANDING CHINESE FINANCIAL STATEMENTS

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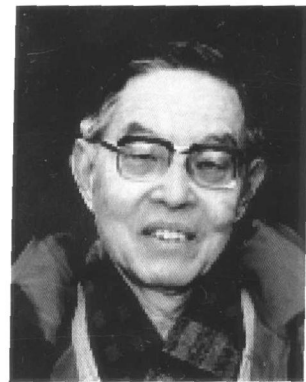
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Preface

China has opened her market to the world. Her economic reform allows foreigners to invest in China through capital market or direct establishment of business enterprises. In either case, accounting information is vital to the decision-making for the investors. Foreign investors may have difficulty in understanding the financial statements prepared under the cumbersome requirements of Chinese accounting law, rules and regulations. It is also found that at this moment of time, there lacks an introductory accounting text for the non-Chinese readers. This book is devoted to assist investors from overseas to master the accounting information provided by the Chinese enterprises. We have attempted to dissect the Chinese financial statements and offer foreign investors or users of the financial statements an easy understanding of accounting information prepared under the Chinese practices. To this end, we expect the investors from overseas may benefit from our readable, concise and accessible presentation. On the other hand, we have attempted to identify major technical and practical issues that prevail in the Chinese accounting practices. Professionals, academics and students may also find this book useful for their purposes.

Precisely, the purpose of this book is to provide those interested parties with an understanding of Chinese financial statements prepared under the latest requirements. To master what the Chinese financial statements intend to reflect is therefore our central theme of this book. We consider the most appropriate approaches to achieve the aim are by studying the real cases and consulting local professionals and academics.

To serve the purpose, the book contains the following features:

- ◆ It aims at simple and readable presentation. This book avoids muddling with the conversion of the Chinese accounting jargons in English terms. It avoids raising personal value judgement on the

accounting principles and practices currently adopted in the Chinese environment. Instead, the book is devoted to reveal what the financial statements intend to tell in the Chinese context. A real example is used throughout the book as the foundation for illustrations.

- ◆ It is targeted for the users of the Chinese financial statements rather than for the preparers. It focuses on the explanation of what the financial statements means rather than on how the information is collected, prepared and disclosed.
- ◆ This book uses financial statements of listed joint stock limited enterprises because such financial statements are publicly available and they embrace all the requirements stipulated in Accounting Standards and Accounting System for Business Enterprises (see Chapter 1). These requirements are also applicable to the foreign investment enterprises and incorporated enterprises with limited liabilities in China.
- ◆ The Ministry of Finance occasionally publishes the English versions of her accounting standards and laws, which contain English versions of accounting terminology. This book will consider in the first instance to use such official terms but would adopt different term if it is appropriate to do so.
- ◆ The information contained in this book is valid up to the time of publishing. For simplicity sake, the terms “Accounting System” or “Accounting Systems” used in this book stand for the currently enforced “Accounting System for Business Enterprises” and “Accounting System for Financial Institutions” unless there state otherwise.

The book contains the following six major areas divided into nine chapters:

Chapter 1: Foundation of Chinese accounting practices

A brief introduction of Chinese accounting regulatory framework and the

current rules and regulations for accounting practices.

Chapter 2: Financial Statements – A Real Example

The financial statements of Nanjing Panda Electronics Company Limited for year ended 31 December 2002, a listed company in Shenzhen, China is used to explain most financial statements items. This Chapter discusses the components of financial statements.

Chapter 3 to 7: Introduction, descriptions and dissection of the items and contents of financial statements

Chapter 8: Understanding of group accounts

Chapter 9: Summarising the listing requirements in China, including annual report, interim report and disclosure of financial matters.

We would like to acknowledge all those whose works have contributed to the completion of this book. Our thanks go to the staff of L. M. Chong & Co. Certified Public Accountants (Hong Kong) for their patience and skill in the typing and re-typing of the manuscript. We are grateful to Dahua Tiancheng Certified Public Accountants for the permission for using the information provided. Our special thanks go to Professor Xu, Zheng-dan of Shanghai University of Finance & Economics for his valuable comments on the initial setting of the book; Dr. Hu, Chun Yuan and Mr. Xu, De, Partners of Dahua Tiancheng Certified Public Accountants for their valuable comments and information.

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1 FOUNDATION OF CHINESE ACCOUNTING PRACTICES

1.1 INTRODUCTION

The accounting principles and legislated rules form the foundation of the accounting practices. More specifically, such principles and legal requirements provide a framework in which the financial statements are prepared. This chapter provides an introduction on the institutional framework for Chinese accounting practices.

China is a country with her power comparatively centralised in the hand of one single governing party. National influences on the financial statements are the marked features in the Chinese financial statements.

The objectives of the preparation of financial statements as stipulated in her Accounting Standards for Business Enterprises (1992) are “Accounting information should meet the needs of the government’s control over macroeconomics management, the needs of the external users to understand the financial position and operating results of a business, and the needs of a business to strengthen its internal management”. In addition, the Accounting System recognises the importance of users’ need and requires the accounting information reported in the financial statements to reflect the financial position, results of operation and cash flows of an enterprise, in order to meet the needs of information users. However, readers must not ignore the prime function of the financial statements is to provide information to facilitate government’s control and policy making on the national economy. The influences from the government play a crucial role in the preparation of the financial statements. Accordingly, the readers should have some understanding of such national influences on the financial statements that they are examining in order to master and interpret them.

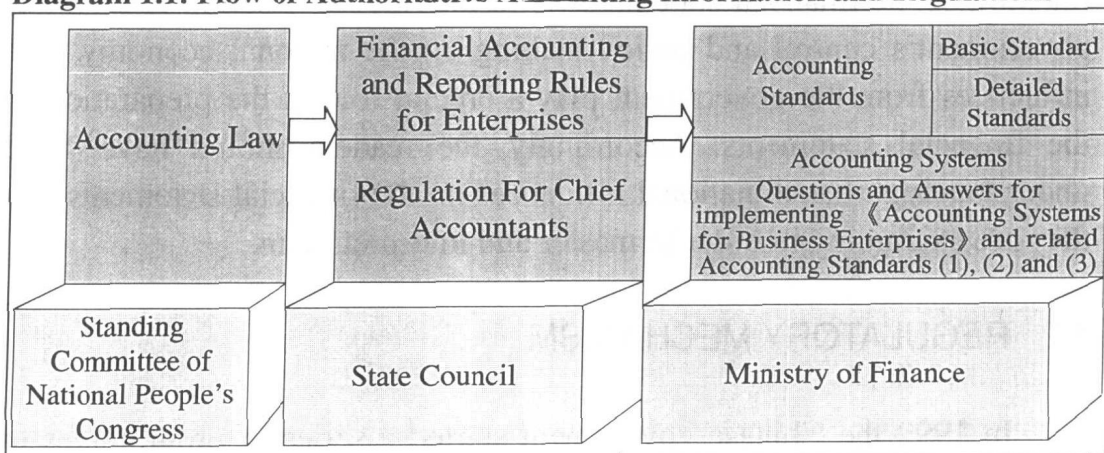
1.2 REGULATORY MECHANISM

In 1992 the Chinese government started a series of programmes to

modernise her accounting system. These series of programmes include the issues of accounting standards, guidelines and reporting requirements, auditing standards and accounting systems; the establishment of an accounting professional body; and the reform of professional accountants and professional practices.

Strictly speaking, there are three levels of rules that govern the financial statements for the companies or enterprises in China. The first level is the statutory laws of the Central Government. The Central Government enacts the Accounting Law (1985, 1992, 1999) which empowers the Ministry of Finance to issue accounting standards, guidelines and reporting requirements; to formulate accounting systems; and to monitor the professional accountants and professional practices. The State Council heading all the government ministries has issued two pieces of Accounting Rules and Regulations for nationwide accounting matters. The State Council is the second level of authority in the hierarchy of the flow of accounting information. The Ministry of Finance is the third level and is charged with the duties to issue details of Accounting Regulations, Standards, Systems, Guidelines, and “Questions and Answers” for implementing 《Accounting Systems for Business Enterprises》 and related accounting standards. From the time to time, the State Council will promulgate legislatures when the Council considers necessary to do so. Diagram 1.1 displays visually the flow of authoritative accounting information issued by three levels of authorities.

Diagram 1.1: Flow of Authoritative Accounting Information and Regulations



The Security Law (1999) and the Companies Law (1994) are important documents which also contain regulations relating to the accounting and financial disclosures for the companies or enterprises. The body responsible for the enforcement of the Security Law is the Chinese Securities Regulatory Commission (CSRC) which is a subordinate to the State Council. One jurisdiction of the Chinese Securities Regulatory Commission is to issue regulations to govern the minimum disclosure of financial information prepared by the listed enterprises.

The Companies Law which has been taken effect from 1 July 1994 is administered by the State Council. Similar to the western concept, the principle of this law is to govern enterprises registration and enterprises conduct so that such enterprises are held responsible to the public, or in China to the government at large. In brief, this Law states the procedures and requirements for establishing and operating enterprises in China. The provisions of the Law detail the disclosure requirements for financial statements, profit determination and distribution of profits and statutory reserves of companies which are of great interest to the readers.

1.3 RULES FOR CHINESE COMPANIES/ENTERPRISES

1.3.1 Accounting Law

Accounting Law is the paramount document for accounting professionals and accounting practices in China. The current accounting law was enacted in 1985 and subsequently revised in 1992 and 1999. There are seven chapters which cover:

Chapter 1: General Provision

Chapter 2: Accounting Measurement and Reporting

Chapter 3: Specific Requirements for Companies and Enterprises in
Accounting Recording, Measurement and Reporting

Chapter 4: Accounting Supervision

Chapter 5: Accounting Organisation and Personnel

Chapter 6: Legal Liability

Chapter 7: Supplementary Provisions

Summaries of seven chapters of the Accounting Law are outlined below.

- Chapter 1: General Provision

This chapter relates to the objectives of accounting practices, and the requirements for performing and monitoring accounting practices. The basic points are:

1. The aims of the Accounting Law are (1) monitoring accounting practices to ensure financial reporting reflecting true and complete information, (2) raising the quality of management with respect to administration and finance; and (3) maintaining a good order for market economy under the socialistic principle;
2. This Law is applicable to government departments, social organisations, companies, enterprises, non-profit making organisations and other organisations that are required to prepare financial records;
3. The law states the rules and requirements in keeping books and records, and the duties and obligation of the enterprises towards to the accounting personnel; and
4. It states the requirements within the accounting departments that could lead to good accounting practices. In particular, it states that the top personnel or the head of the organisation is held responsible for the accuracy and completeness of the accounting information provided by the organisation.

- Chapter 2: Accounting measurement and reporting

This chapter lists the regulations relating to the following areas:

1. the scope of accounting records and their supporting data and evidence
2. the accounting period
3. the reporting currency
4. the requirements and procedures of accounting documents preparation, accounting recording, assets verification and preparation of financial statements
5. the reporting language
6. the filing of documents and financial statements