

Break Through the Chinese Wall

**- Legal and practical guidelines
for establishing a company in China**

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About the book

“Break Through the Chinese Wall” is an accessible handbook which provides an introduction to the fundamental rules, regulations and common practices related to establishing and running a business in China. The handbook provides answers to the most frequently asked questions from our clients.

The handbook has been jointly written by Capital Associates and NCO China. Capital Associates is a Chinese law firm specialised in providing commercial legal services and assistance to foreign companies investing in and trading with China. NCO China is a consulting firm that offers corporate services with regard to the establishment of an enterprise in China, Hong Kong etc., and provides accounting, tax and HR services to foreign investors in China. Both Capital Associates and NCO China serve a variety of clients; from large multinational companies to small and medium sized enterprises.

China’s rapid development means that regulations and practices are constantly changing. The handbook is meant to be an introduction to the current laws and practices in China. Updates and further information regarding the subjects covered by the handbook can be obtained from our offices or websites. Please refer to the contact information in the back of the book.

Birgitta Bundgaard, Lawyer

Jette Renneberg, Economist

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Introduction to Chinese accounting rules

The Accounting Law of the People's Republic of China sets out the general accounting principles for all enterprises. The Accounting Law also empowers the Ministry of Finance to administer accounting affairs and establish uniform accounting regulations, accounting standards and systems. Under this mandate, the Ministry of Finance has issued various accounting regulations, including accounting standards.

Initially, Chinese accounting standards were designed to measure how well production targets were met under a planned economy. Such an accounting system is not very suitable for managing corporations in a market economy like the one China is gradually moving towards. For that reason, a new set of accounting standards called "Accounting Standards for Business Enterprises" (ASBE) came into effect on 1 January, 2007.

The ASBE have brought Chinese accounting practices more in line with international best practices, and a large number of Chinese accounting standards have been replaced with International Financial Reporting Standards (IFRS). The adoption of the ASBE has also made it easier to compare or merge accounts across countries and companies.

Finally, for the first time, China's accounting standards have been officially accepted by a major international capital market; the European Securities Committee, which has approved the ASBE. The EU has decided during a transitional period from 2009 to 2011 to allow "adoption" of the Chinese accounting standards when entering the European market.

At present, ASBE are only mandatory for listed companies, but non-listed companies and FIEs, including WFOEs, are allowed and

encouraged to use the standards, as they are likely to be mandated to conform to the new standards in the near future.

The recent changes to the Chinese accounting standards and other regulations about bookkeeping, accounting and financial reports have made the Chinese accounting concept more similar to the US and EU standards and concepts. While making it much easier to manage international business in China, it also increases the level of information, training, and knowledge of the new rules, required by those drawing up financial statements. Developing such expertise is neither an easy nor a particularly fast process. For detailed information regarding the new accounting procedures, including the accounting system, bookkeeping rules, and reports required by the authorities of China, and their potential impact on foreign investment in China, it is highly recommended that you contact an accounting professional specialized within the area.

Compulsory accounting requirements

FIEs are required to implement the Accounting System for Business Enterprises. That means that FIEs are not allowed to apply international accounting systems that do not comply with Chinese laws and regulations.

Accounting information provided by an enterprise shall reflect all important transactions or events that relate to its financial position, operating results and cash flows. The law also requires that employees, who do bookkeeping and accounting, possess certain qualifications.

Enterprises established in China shall prepare a yearly financial and accounting report. Some enterprises may also be required to prepare semi-annual, quarterly and monthly reports. The fiscal year runs from 1 January to 31 December under the Gregorian calendar.

According to Chinese law, a financial report is a written document, which shows the financial situation and business results of the enterprise. The financial report must include accounting statements, notes and a descriptive overview of the financial situation of the enterprise and other information or data that describe the ongoing business in the FIE.

The yearly accounting report should reflect comparative data for at least two years or two interrelated periods. Accounting elements include a balance statement (assets, liabilities, owners' equity), revenue, expenses, profit and cash flow statements. Small enterprises are not required to include a cash flow statement when preparing financial statements.

The Chinese currency, renminbi (RMB) shall be used as the base currency for bookkeeping in financial and accounting reports. Where an enterprise primarily uses foreign currency in its operations for revenue and expenditure, a foreign currency may be selected as the bookkeeping base currency, but the compiled accounting statements shall be shown in RMB converted from the foreign currency.

Written accounting records, including accounting vouchers, accounting books and accounting statements, are required to be maintained in Chinese. The books can, however, be kept simultaneously in a foreign language.

The master accounting books of the FIE cannot be taken abroad.

A registered accountant or accounting firm must carry out the auditing of the financial and accounting reports of an enterprise in accordance with relevant laws and administrative rules and regulations.

It must be emphasized that rules and regulations within this area are constantly amended. The above description of the compulsory

requirements to FIEs should therefore not be relied upon as a complete and static image of Chinese accounting law.

Frequently Asked Questions

1. *What are the rules regarding the issue of official receipts (fapiao)?*

The rules regarding the issue of fapiaos are detailed and depend on the nature and location of the FIE. Normally, the rules dictate how many fapiaos the FIE is allowed to issue per month, the maximum amount of each fapiao, and finally the maximum total amount of the fapiaos issued.

2. *What are the differences between ASBE and IFRS?*

ASBE is substantially in line with IFRS, but some differences remain, such as:

- Certain specific standards allow only a cost model to compute the value of fixed and intangible assets with the IFRS allowing a revaluation model.
- IFRS provides an option to class all borrowing costs as expenses while ASBE maintains, under certain circumstances, that borrowing costs should be capitalized.
- Biological assets must be measured using a cost model under ASBE, rather than the fair value model allowed in IFRS, unless evidence exists to warrant the use of fair value.
- The new ASBE prohibits reversing impairment losses, but IFRS allows it under some circumstances, preventing only goodwill impairment.
- ASBE have different requirements for presenting the financial report. Expenses, for instance, are presented in different ways depending on the particular aspect of the statement.

3. *Which accounting information must be recorded by the FIE?*

The following information must be recorded by the FIE:

- Receipt and payment of funds and negotiable securities
- Receipt and dispatch of, increase or decrease in, and use of funds and property
- Incurring and settlement of claims or debts
- Increase or decrease in capital and funds
- Calculation of income, payments, expenses and costs
- Calculation and handling of financial results
- Other matters of importance

4. *What are the requirements to an Annual Audit report?*

All FIEs must be audited on an annual basis. Annual audit of the statutory accounts of FIEs must be conducted by a Certified Public Accountant (CPA) registered in China under Chinese law. The deadline for the filing of annual audits is April the following year.

Before the auditor arrives you need to have the following documents prepared and available:

- Accounting vouchers
- Accounting books
- Financial statements
- Tax filing records
- Bank statements
- Other related documents and reports

All invoices (fapiao) must be sealed with the official stamp of the FIE.

Key areas of the audit:

Costs/Expenses report	<p>All expenses must be declared. Official invoices must be provided as supporting documents.</p> <p>Items of special importance: Interest expenses Audit fees Rental/lease expenses Employer's contribution to overseas social security plans Costs paid on behalf of head office</p>
Cash	Bank statements reconciled with cash flow
Tax	<p>Business Tax, Enterprise Income Tax, Withholding Tax etc. shall be excluded from the expenses report.</p>
Balance	<p>Valuation of assets Disposal of gains and losses</p>
Other	<p>Business License (registrations and tax licenses, etc). All employees' registrations, labour contracts, work permits and other administrative matters are up to date. Accounting methods, including currency conversion.</p>

Useful links

Help and advice when establishing a FIE in China

- www.capitallaw.cc
Capital Associates' website.
- www.ncochina.com
NCO China's website.

Government and organizations

- <http://english.gov.cn/index.htm>
The official website of the Chinese central government.
- www.ebeijing.gov.cn
Official website of the Beijing Municipal Government.
- www.shanghai.gov.cn
Official website of the Shanghai Municipal People's Government.
- www.china.org.cn
Government portal site to China that offers broad access to news about China.
- www.fdi.gov.cn
Website of the Chinese Ministry of Commerce directed to foreign investors. The site comprises government news and information about investment directions, economy, statistics and law.
- <http://english.mofcom.gov.cn/>
Official website of the Chinese Ministry of Commerce.

- www.chinainvest.com.cn
China International Electronic Commerce Centre's website. Contains investment news and information about investment projects in China.
- www.tdctrade.com
Hong Kong Trade Development Council's website. Provides information about CEPA.
- www.tid.gov.hk/english/cepa/
Website of Hong Kong Trade and Industry Department. Provides full text documents on all CEPA agreements and annexes.
- www.adb.org
Website of the Asian Development Bank.

Other sources of information about China

- www.transparency.org
Website of Transparency International, a coalition against corruption.
- www.hoover.org/publications/clm
Website of the Hoover Institution of Stanford University. Provides information about China's leadership politics and its foreign and domestic policies.
- www.chinaeconomicreview.com
China Economic Review is a monthly magazine published in Hong Kong covering business, finance and economics in China.
- www.worldbank.org/transitionnewsletter
World Bank newsletters on developing economies.

- www.cia.gov/library/publications/the-world-factbook/
U.S. CIA World fact book.
- www.expatsinchina.com
A guide for foreigners living in China.

Logistics

- www.maps-of-china.com
Maps of Chinese cities, provinces and regions in the principal areas of China.
- www.primecargo.com
Website of the international transportation and freight forwarding company Primecargo.
- www.dsv.com
A transportation company that offers end-to-end transport and logistics solutions.

News in English

- www.chinadaily.cn
Website of China Daily, the Chinese government's official mouthpiece.
- www.scmp.com
Website of South China Morning Post, which is a little less censored than China Daily.
- www.shanghaidaily.com
Website of the local Shanghai newspaper
- <http://english.peopledaily.com.cn>.

Chambers of commerce

- www.amcham-china.org.cn
The American Chamber of Commerce in China.
- www.europeanchamber.com.cn
The European Chamber of Commerce in China.
- www.pek.britcham.org
The British Chamber of Commerce in China.
- www.ccifc.org/
The French Chamber of Commerce in China.
- www.dccc.com.cn
The Danish Chamber of Commerce in China.
- www.swedishchamber.com.cn
The Swedish Chamber of Commerce in China.

Abbreviations

AIC	Administration of Industry and Commerce
AMEA	Anti-Monopoly Law Enforcement Agency
ASBE	Accounting Standards for Business Enterprises
BLTB	Beijing Local Tax Bureau
CAS	Chinese Accounting Standards
CBRC	China Banking Regulatory Commission
CCPIT	China Council for the Promotion of International Trade
CEPA	Closer Economic Partnership Arrangement
CIETAC	China International Economic and Trade Arbitration Commission
CJV	Contractual or Cooperative Joint Venture
CO (CEPA)	Certificate of Hong Kong Origin (CEPA)
COFCOM	Commission of Commerce
CPA	Certified Public Accountant
CSRC	China Securities Regulatory Commission
DTT	Double Taxation Treaty
EJV	Equity Joint Venture
EPZ	Export Processing Zones
FESCO	Foreign Enterprise Service Corporation
FIE	Foreign Investment Entity
FIP	Foreign Invested Partnership
FR	Factory Registration with TID (CEPA)
HKTDC	Hong Kong Trade Development Council
IASB	International Accounting Standards Board
IFRS	International Financial Reporting Standards
LoI	Letter of Intent
MII	Ministry of Information Industries
MOFCOM	Ministry of Commerce
MOLSS	Ministry of Labour and Social Security
NDRC	National Development and Reform Commission
NPC	National People's Congress

PBOC	People's Bank of China
PRC	People's Republic of China
RMB	Renminbi
RO	Representative Office
ROOs	Rules of Origin (CEPA)
SAFE	State Administration of Foreign Exchange
SAIC	State Administration for Industry and Commerce
SAR	Special Administrative Region (Hong Kong and Macau)
SAT	State Administration for Taxation
SIPO	State Intellectual Property Office of the PRC
TID	Hong Kong Trade and Industry Department
TRIPs	Trade-Related Aspects of Intellectual Property Rights (agreement under WTO)
WFOE	Wholly Foreign Owned Enterprise
WIPO	World Intellectual Property Organization
WTO	World Trade Organization

References

We have found inspiration for the handbook on the websites listed under “Useful links”. In addition, various materials from events and presentations together with “Danmarks Nationalbank, Quarterly Review 1, 2009” have been used.

Last, but not least, we have drawn on the long experience of Capital Associates and NCO China in advising clients.

Contact information

Beijing

Capital Associates

Tel: + 86 8447 9588

Email: lukalu@capitallaw.cc

www.capitallaw.cc

NCO China, Beijing

Tel: + 86 10 8447 8118

Email: enquiry@ncochina.com

www.ncochina.com

Shanghai

NCO China, Shanghai

Tel: + 86 21 51699589

Guangzhou

NCO China, Guangzhou

Tel: + 86 20 8751 4381

Tianjin

NCO China, Tianjin

Tel: + 86 22 8210 1281

Denmark

NCO (China Consult APS)

Tel: + 45 3917 9895

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