

III. Professional Infrastructure

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

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

1. Introduction

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

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

²⁸ In 1996 the new Chinese Institute of Certified Public Accountants (CICPA) was formed from the merger of CICPA and the Chinese Institute of Certified Auditors (CICA).

Enterprises (which came into effect in 1993), the issuance of the first batch of *Independent Auditing Standards* in 1995, and CICPA's membership of CAPA and IFAC in 1997.

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

CICPA's main duties and responsibilities are to: (i) manage the registration of CPAs and CPA firms; (ii) regulate the practices of CPAs and CPA firms; (iii) develop and monitor professional standards; (iv) organize and promote professional training; (v) organize the uniform CPA examination; (vi) conduct theoretical research and organize business discussions; (vii) promote domestic and international relationships; (viii) protect the rights and interests of members; and (ix) provide guidance to provincial CPA institutes.³⁰ Table 5 presents a chronology of the development of the PRC's modern accountancy profession.

Table 5: The Development of the PRC's Modern Accounting Profession

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

²⁹ CICPA Charter. 1996. Article 3.

³⁰ CICPA Charter. 1996. Article 5.

- 1992** MOF promulgates first accounting standard (Accounting Standards for Business Enterprises).
- 1993** *Certified Public Accountants (CPA) Law* enacted. The Law governs the accounting profession, sets out CPA qualification procedures, and provides legal backing to CICPA.
- 1995** CICPA limits issuance of CPA certificates only to those who have passed unified CPA examination.
CICPA promulgates first set of Independent Auditing Standards.
- 1996** CICPA and Chinese Institute of Certified Auditors (CICA) merge.
- 1997** MOF and Chinese Securities Regulatory Commission (CSRC) issue regulations to restructure CPA firms. By the end of 1999, almost all CPA firms will have been separated from their sponsoring organizations.
A review of professional ethics leads the MOF to start a clean-up campaign of CPA firms – by the end of the “Rectification” campaign in 1999, 12,700 individual CPAs and 580 CPA firms will be forced from the profession. Most of the cases were due to violation of professional ethics, especially the submission of false audit reports.
CICPA joins CAPA and IFAC.

2. Legal and Regulatory Framework

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

Law on Certified Public Accountants 1993

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

and organizational structure. It sets out the following requirements and covers the following issues:

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

CICPA Charter 1996

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

Other Regulations

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

Table 6: Regulations

Year : Regulation
1996 : Rules on Temporary Performance of Audit Services in the PRC by Hong Kong, Macao and Taiwan Accounting Firms.
1996 : Provisional Regulations on Sino-Foreign Joint Venture Accounting Firms
1996 : Provisional Regulations on Representative Offices of Foreign Accounting Firms

Year : Regulation

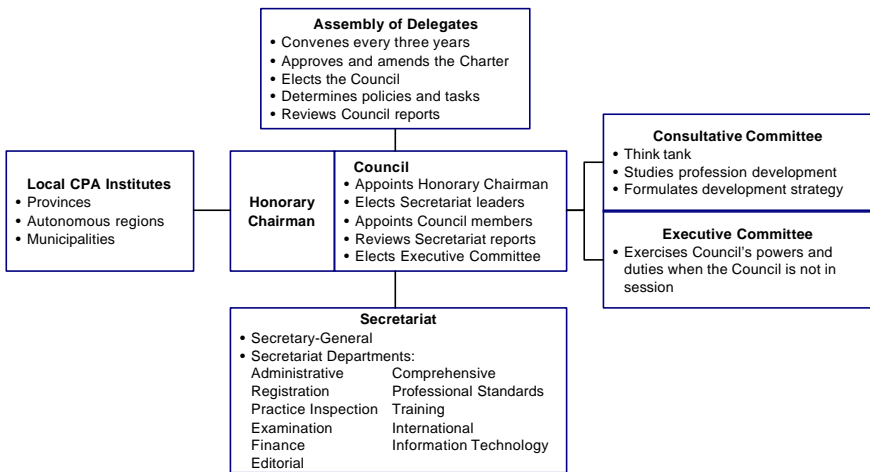
1996 :	Notice Concerning Permission for International Accounting Firms to Identify Member Firms in the PRC
1993 :	Provisional Rules on Temporary Performance of Audit Services in the PRC by Foreign Accounting Firms
1993 :	Notice of Additional Rules of Provisional Rules on Temporary Performance of Audit Services in the PRC by Foreign Accounting Firms

3. CICPA Structure and Financing

CICPA Structure

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

Figure 2: CICPA Structure



As its name suggests, the *Comprehensive Department* is responsible for a variety of activities. First, it coordinates the Institute’s internal activities. Second, it conducts research on the development of the profession and provides this research to the Institute’s leaders for consideration. Third, it prepares regulations and rules for the profession. Finally, it conducts publicity activities. The *Registration*

Department handles the registration of CPAs and CPA firms. It also reviews the recruitment and regulation of non-practising members. The *Professional Standards Department* prepares, and provides interpretations of, professional standards. In doing so, it researches and compares foreign professional standards, and domestic and foreign auditing theory and practices. The *Practice Inspection Department* contributes to improvements in professional ethics and professional service quality through the supervision and regulation of CPA practices.

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

Internal Organization

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

CICPA Financing

Over 84 percent of the Institute's revenue comes from group membership fees (Table 7 refers) – CPA firms are required to pay two percent of their revenue to the Institute.

PROFESSIONAL INFRASTRUCTURE

Table 7: CICPA Revenues for the year ended 31 December 1999³¹

Revenue Type	Y (10,000)	US\$ (000s)
Group membership fees	6,714	8,109
Individual membership fees	64	77
Examination fees	1,200	1,449
Other income (primarily from the provision of services, although a small government endowment is included).	70	85
	8,048	9,721

4. CICPA Membership and Entry Criteria

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

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

Individuals can join the Institute through two routes:

- Those who qualified through the former evaluation procedures (prior to 1995), or
- Those who have passed the uniform examination of all the required subjects and whose membership applications have been approved.
- Honorary members. The Institute's Council has discretion to award honorary memberships to distinguished figures.

Membership Criteria: Chinese Citizens

The membership requirements for Chinese citizens are as follows:

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

³¹ CICPA. 2000. Annual Report for the year ended 31 December 1999.

- have completed a two-year college program at a recognized institution. OR hold a middle-ranked position in an accounting or related area.
- (ii) Examination Must sit and pass the uniform examination in all required subjects:
- Accounting
 - Auditing
 - Taxation
 - Economic Laws, and
 - Financial and Cost Management.
- Applicants must pass all examinations within five years. Exam exemptions can be given to those who hold high-ranking technical titles in relevant subjects.
- (iii) Experience Must have had at least two years' working experience as an auditor.

Membership Criteria: Foreign Citizens

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

Group Members (Accounting Firms)

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

- Two or more CPAs in partnership can establish an accounting firm – partners are jointly liable for the firm's liabilities (Article 23).
- An accounting firm can enjoy limited liability protection if:
 - its registered capital is at least Y300,000, and
 - it has at least five full-time professional staff who are CPA members (Article 24).

Membership Composition

Category	Members as at 31 Dec 1999 ³²
Group members	4,805
Individual members:	
o practising members	60,391
o non-practising members	75,261
Honorary members	8

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

The Uniform CPA Examination

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

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

³² Chinese Institute of Certified Public Accountants. 2000. *Overview*

³³ Tang, Yunwei. 1999. Issues in the Development of the Accounting Profession in China. *China Accounting and Finance Review* Vol. 1(1). March 1999. pp. 21-36.

Table 8: CPA Examination Candidates and Pass Rates (1999)³⁴

Subject	Successful Candidates	Pass Rate
Accounting	22,534	14.4%
Auditing	10,814	15.3%
Financial management and cost accounting	14,767	15.3%
Economic laws	20,594	16.8%
Tax laws	32,388	25.7%

5. Continuing Professional Education (CPE)

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

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

CPE materials are also prepared under specific projects. For instance, training manuals and videocassettes are being developed to explain the new accounting standards that are being prepared under the World Bank-supported *Accounting Reform Project*.

The CPE system has been continuously improved over the past decade. The Institute established the Committee for Preparation and Review of Teaching Materials for the CPE of CPAs in 1999. The Committee’s objective is to improve the quality and effectiveness of continuing

³⁴ CICPA. 2000. Annual Report: For the year ended 31 December 1999. p. 7.

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

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

6. Professional Ethics and Practice Supervision

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

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

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

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

7. CPA Legal Liability³⁵

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

- (i) Administrative liabilities. These refer to disciplinary actions imposed by the Government or CICPA. As per Article 39 of the *CPA Law 1993*, disciplinary sanctions include warnings, practice suspensions, and withdrawal of CPA certificates. In 1996, CICPA issued the *Penalty Rule of CPAs*. In January 1998, the MOF promulgated the *Provisional Regulation on Penalties for Breach of the CPA Law*. Both pronouncements provide detailed explanations of the regulations and associated penalties for violations.
- (ii) Civil liabilities. These result from breach of contract and negligence. In addition to the *General Rules of Civil Law*, Articles 39 and 42 of the *CPA Law 1993*, stipulate that CPAs are obliged to refrain from infringing on the economic interest of the client, or other related parties, and are liable to compensate for any financial loss.
- (iii) Criminal liabilities. The criminal liabilities of CPAs were first stipulated in Article 6 of the *National People's Congress' Decision for Breach of the Company Law*, which took effect in February 1995. According to Article 6, auditors can be sentenced to a maximum of five years' imprisonment, and fines of up to Y200,000, if they provide false verification reports resulting in material damages. The *Criminal Law 1997* also stipulates CPA criminal liabilities for negligence.

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

³⁵ Tang, Yunwei. 1999. Issues in the Development of the Accounting Profession in China. *China Accounting and Finance Review* Vol. 1(1). March 1999. pp. 21-36.

³⁶ Li, Ruoshan, and Hong He. 2000. An Analysis of the Development and Current Situation of the Civil Legal Liabilities of CPAs in China. *China Accounting and Finance Review* Vol. 2(1). March 2000. pp. 104-120.

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

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

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

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

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

- the *Independent Auditing Standards* (1 January 1996) which stipulated standards for CPA conduct, and
- the *Legal Correspondence No. 56 of the Supreme People’s Court* which clarified CPAs’ legal liabilities. On 4 April 1996, the Supreme People’s Court issued a legal letter regarding the issuance of a false capital verification report by the Sichuan Deyang CPA firm. The

letter stated that the firm should be held legally liable and be required to compensate.³⁷

An explosion of lawsuits, regarding capital verification, resulted. In 1997, many cases were ongoing. By 1999, one survey contended that about one-third of all CPA firms had been involved in lawsuits.³⁸ However, the accuracy of this estimate has been strongly questioned. The body of laws regarding CPAs' legal liabilities is self-contradictory in two primary ways, as discussed in the following paragraphs.

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

- Article 161 of the *Securities Law 1998*:
... professional organizations and personnel who provide documents such as audit reports, capital-verification reports, or legal opinions for the issuing, listing, or exchanging of securities must submit their reports in accordance with the procedures required by professional regulations, verify and reexamine their truthfulness, accuracy, and completeness, and accept joint liability for what they are held responsible for.
- Article 39(3) of the *CPA Law 1993*:
It is necessary to investigate the criminal liabilities of accounting and CPA firms proven guilty of violating Article 20 and Article 21 of this law and deliberately submitting false audit reports or capital-verification reports.
- Article 229 of the *Criminal Law*:
Those intermediaries who are engaged in the valuation of assets, capital verification, accounting, auditing and legal services but who commit serious errors of deliberately providing false verifying documents should be sentenced to imprisonment ... for up to five years, and should be fined in accordance with the law....
- Article 219(1) of the *Corporation Law*:
It is necessary to confiscate the illegal income gained by asset valuation or capital verification offices by providing false documents, and to impose a fine of two to five times of that illegal income. ...

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

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

³⁸ Li, Ruoshan, and Hong He. 2000. An Analysis of the Development and Current Situation of the Civil Legal Liabilities of CPAs in China. *China Accounting and Finance Review*. Vol. 2(1). March 2000. pp. 104-120.

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

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

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

- There are contradictions between the four interpretations:
 - *Legal Correspondence No. 56 (1996)* and *Legal Interpretation No. 13 (1998)* stipulate how much CPAs should pay in compensation.
 - *Legal Reply No 3 (1996)* and *Legal Interpretation No. 10 (1997)* say that CPAs should pay compensation with the scope of the untruthful part of their capital verification report or within the verified amount of false capital.³⁹
- The four legal documents focus on capital verification but fail to stipulate compensation for other auditing activities.

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