

VIII. Issues and Recommendations

This chapter presents the issues and recommendations that are associated with gaps or weaknesses in accounting and auditing arrangements. The issues and recommendations are divided into two parts as follows.

- Part One: Where the matter referred to may be considered and, if any action were to be taken, this would be better achieved with external assistance.
- Part Two: Where the matter referred to may be considered and, if any action is to be taken, this may be achieved without the need for external assistance.

Part One. Where Donor Assistance Might be Appropriate

1. Professional Supervision of CPA Firms (Quality Control)

The Rectification Campaign was a short-term, albeit successful, measure. On an ongoing basis, improved supervision can have significant impacts on the quality and availability of professional services. The Chinese Institute of Certified Public Accountants' (CICPA) current supervisory resources are minimal in comparison to the number of CPAs and CPA firms (In January 2000, on average, three staff in each provincial CPA institute were responsible for supervisory activities). Moreover, CICPA considers that the professional knowledge and experience of supervising staff falls short of the necessary requirements for supervisory work.

CICPA is strengthening professional supervision. Initiatives include the establishment of provincial supervision teams, development of reporting systems in the key finance, securities and insurance sectors, and experimental introduction of peer review systems. In the future, the Institute intends to: (i) further strengthen the supervision and control of auditing in key fields (such as financial-institution audits), (ii) establish a business reporting and recording system for accounting firms, (iii) improve CICPA's monitoring and quality-control capacity, (iv) formulate and improve supervisory regulations and widen the peer review system, and (v) continue to expose professional failures in the media.

CICPA has requested assistance to improve supervisory mechanisms.⁸³ This report supports the Institute's proposal for assistance to undertake a project to improve the profession's supervisory regime. CICPA proposes that the project be led by the Vice Secretary-General and organized by the Registration Department.

It is recommended that a project to improve professional supervision be undertaken. The project would involve:

- **studying the existing structures and processes of CPA firms,**
- **examining, and drawing useful lessons from international experience with regards to supervisory regimes (including peer review regimes),**
- **designing a supervisory system for the PRC that takes account of the country's situation and provides sufficient flexibility to deal with environmental changes,**
- **implementing the supervisory system and associated reporting systems,**
- **reviewing and, where necessary, revising CPA legal responsibilities and associated disciplinary regulations, and**
- **improving the competence and effectiveness of managers with supervisory responsibilities through training.**

2. CPA Examination System Reform

The Uniform CPA Examination was introduced in 1991. Since then, the ever growing number of examination candidates is placing increasing pressure on management of the examination. Some 530,000 candidates sat the exam in 2000. There are major issues with the existing examination system:

- management systems are predominantly manual (e.g., distribution of papers and notification of results).
- examinations are held only once each year. This is not ideal for potential candidates and exacerbates organizational issues. The introduction of improved management techniques and technology would enable examinations to be held at least twice each year.

⁸³ CICPA. A Proposition for Technical Assistance to Reform the Chinese CPA Profession and to Enhance the Institution's Organizational Construction. July 2000.

examination preparation, grading procedures, and general organization practices do not meet international standards. Criticisms have been made that passing the examination is a test of memory, not of competence and knowledge.

CICPA has requested assistance to reform the examination system.⁸⁴ CICPA proposes that the project be led by the Vice Secretary-General and be organized by the Examination Department. This report supports CICPA's request.

It is recommended that a project to improve the CPA examination system be undertaken. The project would involve:

- **investigating design options for examination systems,**⁸⁵
- **establishing a database of examination questions,**
- **reviewing and reforming the grading system,**
- **examining the feasibility of, and options for, developing an on-line examination system (in cooperation with the Ministry of Finance's Institute of Fiscal Science),**⁸⁶
- **developing suitable examination software, and**
- **implementing changes to management procedures.**

3. Organization for Accountants (Non-CPAs)

CICPA represents accountants in public practice and essentially has one individual membership category – that of the CPA (either practising or non-practising). However, in addition to CPAs, the PRC has around a further twelve million accountants. These accountants work in the public and private sectors and are classified into four levels: Senior Accountant, Accountant, Assistant Accountant, and Accounting Technician. Qualifications are gained by passing the National Uniform Accountant (NUA) examination.

These accountants have no professional organization. One option would be to create subsidiary membership categories within CICPA,

⁸⁴ CICPA. A Proposition for Technical Assistance to Reform the Chinese CPA Profession and to Enhance the Institution's Organizational Construction. July 2000.

⁸⁵ In February 1999, UNCTAD issued Education Guidelines – agreed by 146 countries of which China is one. The Standards spell out the various subjects in each examination and the level of knowledge required.

⁸⁶ An Internet-delivered examination system, such as that used for Microsoft Certification Examinations, would solve many of the problems that have been identified. Moreover, such a system would improve linkages to outlying regions.

but CICPA does not support this approach. The establishment of a professional body for this group of accountants would provide a transitional route for aspiring CPAs. It would also raise the societal status of public sector accountants, and improve their knowledge and competence.

It is recommended that:

- **a new professional body be established to represent accountants who are not in public practice.**

4. National Uniform Accountant Examination System

The vast majority of the PRC's accountants qualify through the National Uniform Accountant Examination. There are around twelve million of these accountants. As with the Uniform CPA Examination, there are major issues with the existing examination system:

- management systems are predominantly manual (e.g., distribution of papers and notification of results).
- examinations are held only once each year. This is not ideal for potential candidates and exacerbates organizational issues. The introduction of improved management techniques and technology would enable examinations to be held at least twice each year.
- examination preparation, grading procedures, and general organization practices do not meet international standards. Criticisms have been made that passing the examination is a test of memory, not of competence and knowledge.

The Accounting Regulatory Department (ARD) of the Ministry of Finance has requested assistance to reform the National Uniform Accountant Examination system. They propose that the Director of the ARD lead the project. This report supports their request.

It is recommended that a project to improve the National Uniform Accountant Examination system be undertaken. The project would involve:

- **investigating design options for examination systems,**⁸⁷
- **establishing a database of examination questions,**

⁸⁷ In February 1999, UNCTAD issued Education Guidelines – agreed by 146 countries of which China is one. The Standards spell out the various subjects in each examination and the level of knowledge required.

- **reviewing and reforming the grading system,**
- **examining the feasibility of, and options for, developing an on-line examination system (in cooperation with the MOF's Institute of Fiscal Science),⁸⁸**
- **developing suitable examination software, and**
- **implementing changes to management procedures.**

5. China Institute of Internal Auditing: Certification

There is currently no specific internal auditor designation, which contributes to the lack of status of internal auditors in their resident organizations. The adoption of a CIIA certification would help to elevate the perceived value and prestige of internal auditors. Furthermore, the exposure of candidates to examination materials will facilitate the modernization and upgrading of internal auditing practices.

There are synergies between the proposed improvements to CICPA's proposed improvements to the Uniform CPA Examination and the development of the CIIA examination and certification process. In particular, the same technology could be used.

It is recommended that a project to develop CIIA certification and examinations be undertaken. The project would involve:

- **developing a PRC-specific qualification (certification) for internal auditors, and**
- **developing a PRC-specific examination system for internal auditors.**

6. Development of CICPA Training Materials

The CICPA has been active in developing training materials. However, the rapidly changing environment combined with the dramatic increase in Institute members and examination candidates are major challenges. Multimedia and Internet-based technologies present options to prepare effective interactive training materials that are easily redeveloped to reflect the changing environment and can easily be distributed to far-flung regions.

⁸⁸ An Internet-delivered examination system, such as that used for Microsoft Certification Examinations, would solve many of the problems that have been identified. Moreover, such a system would improve linkages to outlying regions.

CICPA has requested assistance to improve the development and delivery of training materials.⁸⁹ CICPA proposes that the project be led by the Vice Secretary-General and be organized by the Training Department. This report supports the request.

It is recommended that a project to improve training materials for CPA continuing professional education. The project would involve:

- **studying options for preparing and providing training materials to CPAs**
- **developing a medium to long-term plan for developing continuing professional education**
- **studying options for developing and delivering training materials using modern technology**
- **developing training materials, and**
- **reviewing the core course teaching materials at the 23 pilot colleges and universities that have established CPA programs.**

Furthermore, it is recommended that the CICPA:

- **review existing interactive accounting training materials (such as those developed by New York Stern University in association with John Wiley and Sons),**
- **study the CNAO's experiences with the development of Multi-media training materials (as supported by AusAID – chapter VII refers),**
- **study the development of video-based training materials under the Accounting Standards Reform Project (as supported by the World Bank – section chapter VII refers), and**
- **consider Internet-based provision of the materials.**

7. Plan for Strategic Development of the CPA Profession

The PRC's accountancy profession is confronting many complex issues. These issues include training, independence, and legal liability. To date, CICPA has dealt with issues in a competent, coordinated fashion – at least to the extent that its operating environment allows. The profession's challenge is to deal with future issues in a similar fashion – a medium to long-term plan would support this.

⁸⁹ CICPA. A Proposition for Technical Assistance to Reform the Chinese CPA Profession and to Enhance the Institution's Organizational Construction. July 2000.

CICPA has requested assistance to support the preparation of a medium to long-term development plan for CICPA and the accountancy profession. The plan would encompass professional development goals, professional administration, and administrative structures and systems.⁹⁰ The CICPA proposes that the project be led by the Secretary-General and be organized by the Director of the Comprehensive Department. This report supports the Institute's proposal for assistance to formulate a medium to long-term development plan and recommends that the plan should make reference to the issues and recommendations contained in this report.

It is recommended that a project to develop a strategic plan for the development of accounting profession be developed. The project would involve:

- **researching the present situation of the Chinese CPA profession,**
- **analyzing existing problems,**
- **examining and drawing useful lessons from international experience in terms of the development of the accountancy profession, and**
- **using this information and the associated analyses to formulate a medium to long-term development plan for CICPA and the accountancy profession.**

8. CNAO Training and Capacity Building

The China National Audit Office (CNAO) is developing a core-training program with World Bank assistance to develop the knowledge and skills of auditors in areas of modern audit theory and practices. In addition, the Nanjing Training Institute has been established.

Small numbers of CNAO staff have been seconded to foreign Supreme Audit Institutes (SAIs) in the past five years for varying periods (one to two years). These secondments have been successful in developing the foreign language, professional, and technical skills of the secondees and have benefited the CNAO.

It is important that the core-training program be effectively implemented. Once the program has been implemented, the CNAO

⁹⁰ CICPA. A Proposition for Technical Assistance to Reform the Chinese CPA Profession and to Enhance the Institution's Organizational Construction. July 2000.

should re-evaluate its training needs. Foreign secondments provide benefits to both individuals and to the CNAO. In particular, the availability of foreign-training opportunities will enhance the attractiveness of the CNAO to potential employees.

It is recommended that the CNAO develop an explicit strategy for professional development. Such a strategy might include:

- **an analysis of current staff competencies against current and future requirements,**
- **an analysis of how well the core training program and other initiatives, such as continuing professional development, are meeting current and future needs,**
- **an assessment of the available options for addressing gaps in professional development, including the resources necessary for each option, and**
- **an integrated time-bound plan that included current professional development initiatives and new professional development initiatives.**

9. CNAO: Computerized Audit Support Systems

The CNAO has been investigating the usage of computerized audit support systems, for instance, software that supports risk analyses, audit planning, working paper preparation, and computer assisted audit techniques (CAATs). However, the CNAO faces financial resource constraints in terms of procuring the necessary hardware and software and undertaking training.

Automated auditing systems offer considerable advantages in terms of audit effectiveness and efficiency. Moreover, they provide frontline auditors with ready access to reference materials such as audit standards. Most CPA firms, and many SAIs in developed countries, use these systems.

It is recommended that the CNAO collate the results of its research into computerized audit support systems and prepare a business case that includes an assessment of hardware, software and training requirements for consideration by the Government and other parties. The case should reflect the results of studies undertaken through ADB TA 3103-PRC.

10. China Institute of Internal Auditing: Standards

The *Audit Law* and the *Accounting Law* identify guiding principles, as well as the rights and responsibilities for internal auditors, but no detailed standards are provided which specify qualifications, competency, or the necessary due diligence processes and procedures that are required from internal auditors. Training and education needs cannot be adequately determined without clear standards. While the *Professional Standards* developed by the International Internal Auditing (IIA) Association were translated into Chinese in 1994, the document is treated as a reference and learning vehicle.

The development of professional standards that reflected the working environment in the PRC would be a major milestone in the development of the CIIA as a professional organization.

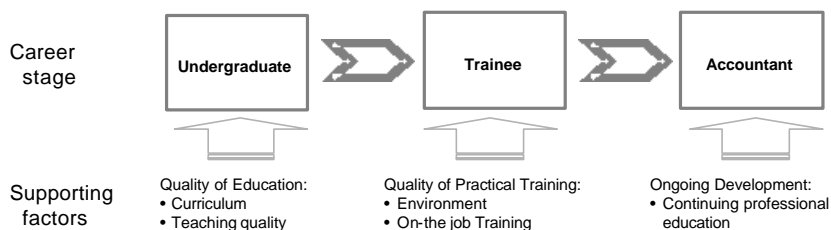
It is recommended that the CIIA should develop:

- **a set of professional standards and guidelines and training materials to support their introduction, and**
- **Internal Auditing Standards, based upon International Internal Auditing Standards.**

11. Training for Accounting Lecturers and Professors

In order to develop competent accounting graduates, the trainers themselves must be thoroughly conversant with modern-day practises and trends. The quality of undergraduate teachers is a key factor in developing competent accountants (Figure 6 refers).

Figure 6. Developing Competent Accountants



A rudimentary estimate, based on an average of 10 teaching staff at each of the 500 institutions teaching undergraduate accounting, is that the PRC has about 5,000 accounting teachers (higher education). However, the training target group for the National Accounting Institute does not include accountancy professors and lecturers.

It is recommended that:

- **A specific training program for accounting professors and lecturers be developed and implemented: and**
- **A professional organization be established in order that accounting professors and lecturers may further their education and share their technical knowledge through a common forum.**
- **accounting professors and lecturers be included in the targeted training group for the National Accounting Institute.**

12. Development of Public Sector Accounting Standards

There are currently no firm plans for government organizations to report in accordance with the recently issued International Public Sector Accounting Standards (IPSASs). The Accounting Reform Project does however include a component for a research study into the feasibility of developing accounting standards for government and not-for-profit organizations (chapter VII refers).

It is recommended that, if the accounting reform project research supports the development of accounting standards for government and not-for-profit organizations:

- **a project to implement public sector standards be developed, and**
- **a project to train government accountants in public sector standards be developed and implemented.**

Part Two. Where External Assistance is Not Required

13. Conflicts between Standards and Regulations

Introduction

In 1992, the Ministry of Finance published the revised uniform accounting systems. The coexistence of the new accounting standards with the revised uniform accounting systems was justified because: substantial retraining was required for practitioners; large government bodies, which relied on accounting information from the uniform accounting systems to regulate different economic sectors, still existed; and national statistical reporting was reliant on accounting information from the uniform chart of accounts and uniform format of financial statements.

In 2000, most of the changes have already been taken up or are covered by other laws and regulations – for instance, the *Accounting Standard for Business Enterprises*, the *Tax Law*, and the *Company Law*. Furthermore, although the uniform accounting system emphasizes flexibility, it contains many detailed requirements; for instance, various ratios are prescribed (bad debts expenses, and entertainment expenses). The approach of issuing a revision of the uniform accounting systems was sound as a transitional measure. However, the full adoption of the new accounting standards, and the withdrawal of the uniform accounting system should remain the ultimate goal.

The coexistence of accounting standards and the uniform accounting system regulations frequently confuses accountants and auditors. On one hand the accounting standards require principles to be followed (for instance, that of prudence). On the other hand, the uniform accounting system regulations are extremely prescriptive.

There are distinct differences between financial reporting for listed companies and the reporting basis for non-listed companies (including SOEs).

Listed Company Reporting

A greater number of the new Accounting Standards apply to reporting by listed companies than to non-listed companies (chapter I refers). Even so, the application of statutory reporting requirements (uniform accounting system regulations) can yield quite different results than would international accounting standards – Table 10 on page 69 presents an example where, a company's statutory accounts disclosed earnings-per-share of Y 0.13 but, when the accounts were adjusted to the full IAS basis, earnings-per-share were only Y 0.01.

Non-Listed Company Reporting

Nonlisted companies include most financial institutions (only two small-medium-sized banks are listed) and SOEs. The accounting regulations that apply to these organizations stipulate doubtful-debt provisions, loan provisions, etc. Consider two companies that are the same, and which began operations this financial year, except that:

- Good Collector's stringent credit-approval procedures mean that only 2 percent of its receivables are not likely to be collected.
- Bad Collector's lax debt-collection procedures mean that as much as 20 percent of its receivables are not likely to be collected.

Table 14 presents a simplified example which compares the results of these two companies where internationally-accepted accounting practices had been applied.

Table 14: International Practice

Y '000	Good Collector Co. Ltd.	Bad Collector Co. Ltd.
Balance Sheet		
Gross receivables	50,000	50,000
<i>Less:</i> Provision for doubtful debts	(1,000)	(10,000)
Net receivables	<u>49,000</u>	<u>40,000</u>
Income Statement		
Revenues	100,000	100,000
Expenses		
General	80,000	80,000
Doubtful debts expense	<u>1,000</u>	<u>10,000</u>
	<u>81,000</u>	<u>90,000</u>
Profits before taxation, etc	<u>19,000</u>	<u>10,000</u>

Compare these results with those in Table 15 that presents an example where PRC statutory reporting requirements have been applied (for the purpose of the example, it is assumed that the mandated provision level for doubtful debts is set at 2 percent).

Table 15: Mandated Provisioning Levels set at Two Percent

Y '000	Good Collector Co. Ltd.	Bad Collector Co. Ltd.
Balance Sheet		
Gross receivables	50,000	50,000
<i>Less:</i> Provision for doubtful debts	(1,000)	(1,000)
Net receivables	<u>49,000</u>	<u>49,000</u>
Income Statement		
Revenues	100,000	100,000
Expenses		
General	80,000	80,000
Doubtful debts expense	<u>1,000</u>	<u>1,000</u>
	<u>81,000</u>	<u>81,000</u>
Profits before taxation, etc	<u>19,000</u>	<u>19,000</u>

While these regulations may improve official statistics and enhance tax collections, they are not in line with internationally accepted accounting practices.

It is recommended that laws and regulations be amended as necessary so that, where a conflict arises between regulations and the Accounting Standards, the Accounting Standard treatment overrides the regulated treatment.

14. CPA and CICPA Independence

The most important element among the fundamental ethical principles accepted by the international accounting profession is independence. As a regulatory organization for CPAs, the status, authority, and independence of CICPA directly influence the independence of Chinese CPAs. However, most CICPA officials are Ministry of Finance employees and the organization works under the direct supervision of the Ministry of Finance. As such, CICPA is more a government organization than a professional body. However, in late July 2000, the Ministry of Finance tentatively agreed that CICPA could be de-linked and re-established as an independent, professional organization. This will require amendments to the *CPA Law 1993*.

It is recommended that de-linking of the CICPA from the MOF be pursued as a priority.

15. Accounting Standard-Setting Body

The issue of whether accounting standard-setting should be a government or private-sector function is a common one for many countries. This was certainly the case in the PRC, which took the former option. The assignment of this role is influenced by country-specific factors including: the role that the Central Government plays in the economy;⁹¹ the status of the legal system – in European countries, where the status of the legal system is considered to be of the utmost importance (e.g., Germany and France), financial reporting requirements are codified in laws; and the influence of historical factors – for instance, accounting standards in Anglo-Saxon countries were traditionally

⁹¹ Zeff, Stephen. 1987. Setting Accounting Standards: Some Lessons from the US Experience. *Accountant's Magazine*. December. p. 27.

developed by professional organizations, such as the Financial Accounting Standards Board (FASB) in the US, and the Accounting Standards Committee in the UK.⁹²

In the PRC, most observers agreed that accounting standard-setting should be a government function on the basis that only the Government, has the required authority to enforce the implementation and monitoring of accounting standards. This report concurs with the decision to initially assign standard-setting responsibilities to the Ministry of Finance, for two reasons. First, the Ministry of Finance had the necessary authority to enforce the implementation and monitoring of accounting standards. Second, the profession arguably lacked the necessary depth to support a self-regulating regime. Furthermore, the personnel in the relevant departments of the Ministry of Finance had a strong comparative advantage in standard setting and were respected by the accounting profession and by finance institutions.

At this point, these arrangements should be seriously reconsidered – particularly in light the conflicts between accounting standards and accounting regulations (see above).

It is recommended that the Ministry of Finance consider assigning accounting standard-setting responsibilities to an independent body that is comprised of financial sector representatives, financial sector regulators, and representatives from the accountancy profession.

16. The Availability of Professionally Competent CPAs⁹³

An increased demand for accounting services, and for the professionals able to provide those services, was a natural consequence of the economic reforms. The following issues have been identified in this respect.

⁹² Liu, Kin Cheung and Wei Guo Zhang, 1996. *Contemporary Accounting Issues in China: An Analytical Approach*. Prentice Hall: Singapore. pp. 9-12.

⁹³ 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.

Box 5: Availability of Certified Public Accountants in 1992

According to a report prepared by the Ministry of Finance in 1992; due to the shortage of CPAs, only 30 percent of foreign-invested enterprises, 20 percent of domestic joint ventures, and 15 percent of group companies, were audited by CPAs even though their financial statements were required to be audited by independent auditors.⁹⁴

First, the CPA certification process hindered professional quality improvements. Before the introduction of the Uniform CPA Examination, subjective entry criteria prevailed. Consequently, there was a wide variation in the quality of CPAs. This was exacerbated by other factors, such as the ageing of CPAs, the lack of emphasis on continuing professional education, and a general lack of understanding of modern business practices.

Second, historical factors – mainly the hiatus associated with the Cultural Revolution, combined with the educational changes that accompanied the economic reforms – created significant age-related differences among CPAs. According to a MOF survey, 78 percent of CPAs were over 60 years old in 1992. In contrast, large numbers of young university graduates joined the profession after the unified CPA examination was introduced in 1991. The first group had experience but lacked a modern accounting education. Furthermore, they were getting too old to be in management positions. Conversely, the young CPAs were technically qualified but lacked the experience to hold senior positions. This situation has an upside. The development of the accountancy profession in former Soviet Union countries, which face similar transition problems to the PRC in terms of developing a market-oriented accounting profession, is hindered by the reticence of senior members to adopt new practices. In contrast, the significant demographic discontinuity in the PRC's accountancy profession means that this issue will largely resolve itself in the next five to 10 years.

Third, increasingly complex business transactions have accompanied the PRC's rapid economic development. The professional knowledge and competence of the PRC's CPAs should keep up with these changes through developments to the CPA examination syllabus and to CPE. This is not the case. Some CPAs in smaller firms do not understand newly promulgated accounting standards, such as cash flow

⁹⁴ Ministry of Finance. 1992. Outlines of Programs and Policies for Accelerating the Development of the Accounting Profession. *Journal of Certified Public Accountants*, December. China. pp. 1-9.

statements. This makes it difficult for CPAs to exercise accurate professional judgment, which may result in audit failures. Many of the malpractice suits filed against CPA firms in recent years are related to this. Fourth, the shortage of CPAs in some remote inland areas is particularly serious.

Professionally competent CPAs are the product of years of specialized education, on-the-job training, and practical experience. There are two options available to quickly increase the number of CPAs: import CPA skills, and / or lower professional admission criteria. By opening up entry to the domestic accounting market, the PRC has implicitly decided to import CPA skills. It has prudently opted not to pursue the latter option.

The increased demand has made accountancy a career choice for many young Chinese. The CICPA estimates that around 10 percent of tertiary students are opting for accountancy majors. In combination with high entry standards (employment screening and the Uniform Accounting Examination), this means that the profession is employing many of the best and brightest graduates. The professional environment that these graduates are entering is conducive to rapid skills development because of professional development initiatives, e.g., the establishment of the National Accounting Institute, and external factors, e.g., CPA firms have introduced structured professional development and on-the-job training programs because of litigation threats and improved professional supervision.

In summary, the availability of professionally competent CPAs will be a natural consequence of the mixed-market economy. Support can be provided through the continuation of existing initiatives on training and supervision.

17. CPA Legal Liabilities

While the exposure of the accountancy profession to legal litigation has had a beneficial effect on professional ethics and audit quality, the current legal situation does not accord with legal principles of equity, fairness, and certainty. In response to the legal contradictions, CICPA has taken, or is taking, the following measures:

- In March 1998, CICPA organized a conference to examine CPAs' legal liabilities. The conference not only helped CICPA summarize the situation, but also helped legal participants gain a better understanding of the complexity of the area.

- On 22 July 1999, the Ministry of Finance issued *Financial Coordination No. 102 (1999)*, which further clarifies the role of capital-verification reports. In particular, the document says that the reports can only provide a reasonable guarantee, rather than an absolute one, because of the inherent limitations of capital verification.
- CICPA, with MOF support, is currently working on a revision of the *CPA Law 1993* to address the weak points of existing laws and regulations.
- The MOF and CICPA are coordinating with legal officers from the Supreme Court.

Addressing the issues surrounding CPA legal liabilities in the PRC is a complicated and difficult task. Other countries also struggle with this issue, for instance, the United States Congress limited CPA liability with the approval of the *Private Securities Litigation Reform Act* in 1995. The revision of the *CPA Law* and associated regulations will be a major step forward. Further steps require realignment of fundamental laws including the *Criminal Law* and the *Civil Law*.

18. CPA Professional Ethics⁹⁵

Business ethics were not a serious problem in the environment of the planned economy. They are in the new mixed-market economy. The Rectification Campaign identified hundreds of examples of ethical violations. These violations involved the preparation of falsified financial statements, and the inflation of asset values (for instance).

CICPA has made tremendous efforts to improve professional ethics. Specific initiatives include: developing and promulgating ethical standards and guidelines, strengthening practice supervision, highlighting ethical breaches in the media, and introducing professional ethics into the tertiary curriculum, into the curriculum for the CPA uniform examination, and as a Continuing Professional Education (CPE) topic. In addition, the revised *Accounting Law* has strengthened the penalties for breaches. These now range from Y2,000 to Y100,000.

Professional ethics have been the focus of considerable debate in international academic and professional circles for the past 20 years. The debate centers on the effectiveness, or otherwise, of teaching professional ethics. This report's view is that a set of professional and

⁹⁵ 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.

ethical standards and guidelines is useful. However, these standards should be clear and practical. The guidelines should provide real-life examples to illustrate the differences between acceptable practices and unacceptable practices. Moreover, ethics should be taught by way of practical case studies, not by lectures on philosophy. CICPA's standards, guidelines, and training practices meet these criteria. This report considers that CICPA's multi-pronged approach on this issue is appropriate.

19. Structure and Contents of Accounting Standards

General Versus Specific Accounting Standards

Under the old uniform accounting system, very detailed instructions governed accounting and reporting practices. These instructions (regulations and procedural guidelines) differed based on entity size, ownership, and industrial characteristics. There was controversy as to whether the same set of accounting standards could be applied to all business enterprises regardless of their special characteristics. One group argued that industry- and ownership-specific accounting standards should be developed. Another group argued that this approach would not be cost effective and would conflict with the overall objective of replacing the existing uniform accounting system with accounting standards. The PRC decided to adopt a two-pronged approach to this issue. First, general accounting standards are being developed (e.g. the *Basic Accounting Standard*). Second, sector-specific accounting standards will be developed. For instance for the banking sector, and for the oil and gas sector.

This report concurs with this approach, on the basis that it has successfully reconciled the divergent views, and is consistent with international practice. For instance, the proposed standard for the banking sector will be based on *IAS 30*.

Conceptual Versus Procedural Content

In the early stages of accounting-standard development in the PRC, one group held that standards should only consist of fundamental accounting principles and concepts like reliability, consistency, and materiality because these principles and concepts form the basis on which accounting information is prepared. Another group recommended that accounting standards should be defined as detailed and authoritative, rules that accountants should comply with in

financial reporting. These views have been reconciled in the *China Accounting Standards*. The *Basic Accounting Standard* sets out concepts and principles, for instance: “Assets are economic resources, which are measurable by money value, and which are owned or controlled by an enterprise, including all property, rights as a creditor to others, and other rights (Article 22).” Individual accounting standards provide detailed rules. For instance, Article 27 of the *Investment Standard* states that, “An enterprise should disclose the following items relating to investments in the financial statements: significant restrictions on the realisability of investments or the remittance of investment revenue. Appended materials (such as report formats) and supplementary guidance materials are published with accounting standards.

This report concurs with the approach taken, on the basis that it has successfully reconciled the divergent views, and is consistent with the approach taken by other jurisdictions. For instance, US Generally Accepted Accounting Practices is comprised of Financial Accounting Standards Board’s Statement of Financial Accounting Concepts (SFAC) and Statements of Financial Accounting Standards (SFAS).