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Shanghai Municipal Government's Guideline for Merger and acquisitions associated with State-owned Company and Foreign Investors

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## Shanghai Municipal Government's Guideline for Merger and acquisitions associated with State-owned Company and Foreign Investors

This year the Shanghai municipal government issued a new guideline for foreign investors to acquire State-owned enterprises (SOE) in Shanghai.

The guideline confirms that foreign investors can set up wholly foreign owned enterprises (WFOE) or joint venture (JV) by merging or acquiring state-owned companies (SOE) if the shares purchased are more than 25%.

The Shanghai government encourages the following mergers and acquisitions, which can:

- 1: Bring in new products and advance technology
- 2: Explore new resources for agriculture, transport and important raw materials.
- 3: Introduce high technology for new industries.
- 4: Make use of recycled resources or new resources against pollution.
- 5: Improve the standard of technology in order to compete in the international markets.
- 6: Improve management in enterprises and increase productivity.

Foreign investors need to follow the government's guideline showing which types of projects are encouraged, prohibited, limited or completely banned for foreign investments.

The role of Shanghai Assets & Equity Exchange (SAEE) or Shanghai Technology Stock Exchange (STSE) has been strengthened by this guideline. It is the first time for SAEE and STSE to extend their examination to foreign investors' M&A activities associated with SOEs.

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The processes of purchasing a state-owned enterprise are as follows:

1: Buyers or Sellers of enterprises should get an application form from SAEE or STSE

2: SAEE or STSE will exam the application form and dealing contract with references to the appraisal report issued and authorized by appraisal company.

If the selling price is less than 90% of the appraisal value, SOE should make a special report to Shanghai State-owned Assets Management Bureau.

3: Essential documents should be submitted to Shanghai Municipal Foreign Economic Relations and Trade Commission (SHMFERTC) for approval.

4: After approval, the new enterprise should be registered by the Administration for Industry & Commerce.

This guideline also included special deduction from the selling price when foreign investors can keep the superfluous employees of SOEs.

### Changes to the Foreign Exchange Account for Current Account Items

*The Notice of the State Administration of Foreign Exchange on Issues Related to Making Further Adjustments to the Policies for Administration of Current Account Foreign Exchange Accounts was issued on September 9, 2002 and will come into force on October 15, 2002.*

The Notice and the Detailed Implementing Rules for Administration of the Current Account Foreign Exchange Accounts of Domestic Organizations (brief below) introduce a unified legal regime for the current account foreign exchange accounts of both wholly Chinese-owned enterprises and foreign-invested enterprises.

Of particular note are the unified rules for the caps on current account foreign exchange accounts, which replace the cap rules that previously applied to foreign-invested enterprises.

The Notice and the Implementing Rules also provide for the consolidation of current account foreign exchange settlement accounts and special-purpose foreign exchange accounts. In principle, the cap on the current account foreign exchange account of a domestic organization (this term includes foreign-invested enterprises) is to be 20% of the domestic organization's current account foreign exchange receipts in the previous year. When a domestic organization that had no current account foreign exchange receipts in the previous year opens a current account foreign exchange account, the initial cap should not, in principle, exceed an amount equivalent to US\$ 100,000.

Current account foreign exchange settlement accounts and special-purpose foreign exchange accounts opened before the Notice comes into force may continue to be used in accordance with their original cap and scope of permitted payments and receipts.

However, domestic organizations must carry out the procedures with the local Foreign Exchange Authorities for combining foreign exchange accounts and having their cap re-approved before December 31, 2003.

□ (China Legal Change - October 1, 2002)

[Taxation Terms](#)

增值税

"Zeng Zhi Shui"

(Value Added Tax)

增值税

"Ying Ye Shui"

(Business Tax)

消费税

"Xiao Fei Shui"

(Consumption Tax)

所得税

"Suo De Shui"

## A closer look at the new "Accounting for Business Enterprises" accounting system

As companies begin to prepare their accounting reports under China GAAP and International Accounting Standards (IAS), we thought it may be useful to briefly run through the new "**Accounting System for the Business Enterprise**" - which is mandatory for all reporting entities in China (both domestic and Foreign Invested Enterprises (FIE)) and look at the major changes.

Essentially the changes:

- Provide revised accounting standards in closer line with International Standards
- Were initially only mandatory for all joint stock limited enterprises (December 29, 2000), and other enterprises were encourage to adopt
- Came into effect on January 1 2002 for all FIEs in China
- Were designed to improve financial reporting by business enterprises in China
- Abolish the previous Accounting system for Foreign Investment Enterprises (1992).

The New System aims to provide a Comprehensive Reporting Framework, including less reliance on rules-based accounting and more emphasis on fundamental accounting principles such as consistency, timeliness, understandability, accrual basis recognition, matching, impairment, materiality, prudence and transparency. As such, the emphasis of the system is now focused more on "substance over form", something which has not been integrated within the existing Chinese accounting standards or regulations.

Generally speaking the over-riding changes that the New System introduces are:

1. Extends the scope of provisions for asset impairment, to include an extra 6 asset classes, and relaxes restrictions on provisioning. This ensures that the PRC GAAP requirements for asset impairment for all 8 classes are consistent with IAS.
2. Attaches greater importance to the requirements of the prudence concept through use of the matching principle to record expenses, valuation of assets, provisions for contingent liabilities and writing off of unamortised expenses.
3. Clarifies the application of the equity method for accounting for investments.
4. Introduces measures to curb profit manipulations through stricter controls over income recognition from debt restructuring and non-monetary transactions.
5. Incorporates and develops the content of specific accounting standards already issued (e.g. Leases, contingencies, borrowing costs, non-monetary transactions etc) into specific sections.
6. Extends the content of financial statements and notes of disclosure. New content required includes such reports as statement of changes to shareholder's equity, a statement of provisions for asset impairment, segment reporting etc

Whilst the changes have pulled the **PRC GAAP into closer alignment with International Accounting Standards**, there are still some major differences regarding:

<b>Pre-operating expenses</b>	<b>R &amp; D expenditure</b>	<b>Provisions for liabilities</b>
<b>Finance leased assets</b>	<b>Valuation of non-current assets</b>	<b>Government grants</b>
<b>Borrowing costs</b>	<b>Non-consolidated investments</b>	<b>Employee benefits</b>
<b>Goodwill</b>	<b>S-T investment income</b>	<b>Debt restructuring</b>
<b>Dividends declared</b>	<b>Deferred tax</b>	<b>Non-monetary transactions</b>

Whilst the new system, it is argued, is certainly a move in the right direction to providing greater Corporate Governance, transparency and information to users, many experts acknowledge that the real challenge will be for the Chinese accounting profession. Implementing a country-wide system has proven impossible thus far and, with such vast discrepancy in accounting and reporting already existing throughout China, the Chinese Institute of Certified Public Accountants, the Ministry of Finance and the China Securities Regulatory Commission certainly have their work cut out for them.

In light of the extensive changes, LehmanBrown has decided to host a 1.5 day seminar in November to cover the changes and explain how the New System is applicable to FIEs in China:

### **Special Seminar Opportunity - "Accounting System for Business Enterprises"**

LehmanBrown China is pleased to announce a seminar to explain the inner workings of the new "Accounting System for Business Enterprises" in Beijing.

These seminars present an opportunity for book-keepers, accountants, financial managers and directors, as well as other interested parties, to get up to date on the changes and application of the new Accounting System for Business Enterprises in China which is mandatory for all companies in China from January 1, 2002. With the crackdown on taxation, especially for FIE companies, currently underway this seminar is integral for anyone preparing, interpreting or using financial statements in the PRC.

**For registration** information visit: [www.lehmanbrown.com/CrisisSeminar.htm](http://www.lehmanbrown.com/CrisisSeminar.htm) or for phone registration call: **Rachel Wan, Tel: (86 10) 8532 1720** today.

Space is available for a maximum of 15 participants at each 1.5 day seminar so be sure to book early.

## ***"Providing an alternative in China"***

**[insights@lehmanbrown](mailto:insights@lehmanbrown) provides updates of the latest taxation and accounting regulations in the People's Republic of China. It is designed to provide you with interesting and informative information to assist in your dealings with China or any China-related issues that you may encounter.**

**If you do not wish to receive this newsletter, we have provided an unsubscribe facility below.**

LehmanBrown also provides a monthly newsletter *Peeling the Onion* which investigates certain topical issues affecting businesses in China, particularly for those companies and individuals with operations in the PRC, or looking to establish a presence in-country.



#### **Recent editions include:**

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  - ▶ Corporate Valuations in China
  - ▶ Crisis Management in China
- ▶ China's Changing Tax Environment
  - ▶ Internal Controls in China
  - ▶ Establishing an SME in China
- ▶ Managing Your China Business Under SARS
  - ▶ Treasury Management in China
    - ▶ Banking in China
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