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Peeling the Onion

The Changing Role of CFOs and Accountants in China



Accountants in China have something of a tough time, often perceived by senior management as expensive cost centres with little real value to add to the future growth of a company. Their image resembles a throwback to the days when accountants were seen as little more than boring number crunchers, necessary only to check that all was in order and keep governing authorities at bay. Add to this occasional pressure on accountants to adjust a few numbers here and siphon off a few million renminbi there, and you will find the position of the accountant in China worsened further still.

There are around sixty thousand Certified Public Accountants (CPAs) in China employed in more than four thousand accounting firms, the majority with less than one hundred accountants. Of this, there are around thirty larger local firms, a number of international-run firms in the middle ground such as LehmanBrown, and the 'Big Four'. Most of the local firms focus on audit services, which, whilst teaching a good grounding in compliance rules and risk identification, do not necessarily teach value-adding or strategic thinking. There are currently no management accounting qualifications in China such as the UK-based Chartered Institute of Management Accountants (CIMA). Therefore, there can be an over emphasis in China for accountants and, in turn Chief Financial Officers (CFOs), to focus on statutory compliance, often at the expense of identifying business drivers and feeding management information.



Chinese Business Environment

In order to fully appreciate the difficult position of accountants in China, particularly that of the management accountant whose role is really about adding real value to the company through effective forward planning, understanding key business drivers and minimising the impact of future potential financial threats, it is first necessary to know something about the business environment. Unaffected by the SARS crisis and the global economic slowdown, in 2003 China attracted \$54 billion in foreign direct investment (FDI). The period from January to June last year saw the approval of 18,877 new foreign invested enterprises (FIEs), an increase of 22.3% compared with the same period in 2002.

In China it is not possible to simply import foreign methods of doing business however and bureaucracy, rules and simple procedures can generate mind-boggling quantities of red tape. Many foreign companies investing in the Chinese market find they have to discard the business formula used in other markets and start anew.

Simply put, Chinese business practices are different to those in the West. Negotiating and building effective relationships is vital to the success of doing business in China. Business relationships are based on *guanxi*, meaning connections and somewhat akin to the phrase, "It's not what you know, but who you know." Many foreign companies in China conduct business based on market situations without too much consideration for the importance of building personal relationships with those involved. The obligation that having 'good *guanxi*' carries can be developed into a loyalty that ordinary business relations cannot achieve.

Unfortunately in China, with its still developing legal system and the tendency by authorities to 'turn a blind eye' for the right price, corrupt dealings are still common. The Government is working hard to try and stamp out corruption but it is still rife, the greater so, the further you travel away from the main cities. Of key interest here is the fact that accountants, by the very nature of their job are often key players in corrupt dealings, and are therefore under pressure to be ethical and report to the Government any wrongdoings. Accountants are also often paid low salaries out of the bigger cities and therefore temptation exists to share the spoils rather than report them.

Chinese history has also affected business outlook and a tendency by foreign business people in the past to attempt to dominate proceedings has left some Chinese business people sceptical of their foreign counterparts. Consequently many perceive that it is wrong for foreigners to expect to make a big profit in China, sometimes citing their country's current relative poverty to justify this view.

Chinese society generally discourages individuals of straying from the generally accepted way of doing things. Though the overall structure in many Chinese companies is somewhat autocratic, managers suffer from a lack of overall autonomy and often do not realise the importance of generating ideas outside of their accepted job scope. Having grown up in an education system that advocates learning by rote and accumulation of facts at the expense of creativity, most Chinese managers are consequently unwilling to delegate, a problem which is exacerbated by the fact that in any given department there is usually only one decision maker.



East Meets West

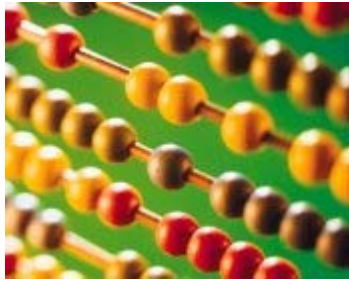
You might therefore be forgiven for thinking that Chinese companies were having a rather tough time competing with their foreign counterparts, whose style of management might be considered to better suit China's current evolution from a planned economy to a market economy. On the contrary, many modern Chinese enterprises are thriving and the key to their success is often attributed to their ability to adapt and combine western management practices with their own. Despite the growth of foreign computer manufacturers like Dell into the Chinese market, local Chinese brand Legend still claims a considerable chunk of the market.

The computer industry in China, like everywhere else in the world, has declined lately and as a result Legend is embarking on several new tactics to get things moving again. It has moved into new markets in China such as Mp3 players and digital cameras and has started to lay the groundwork to begin providing IT services and network products. Most ambitiously, and something of a rare move for Chinese companies, it has long-term plans to take its business overseas. In April last year the company took a first step towards this by changing its English brand name.

Such a move is becoming increasingly popular with many Chinese companies, and with an increasingly sophisticated and wealthy customer base, many are starting to pay serious attention to brand building. The country's largest sportswear manufacturer recently launched a new advertising campaign costing eight times the cost of their previous advertising budget. After a good length of time focusing on trying to undercut their expensively priced foreign rivals, many Chinese companies are starting to realise that branding pays.

Until now, perhaps the only Chinese band with a global presence is Haier, a diversified manufacturer of a vast array of more than 80 products ranging from refrigerators and washing machines to air conditioners and televisions. Haier sells its products in more than 150 countries and owns 13 factories outside China. The CEO of the Haier Group believes that his company can extend its strong domestic brand reputation into the West by introducing innovative products for specific consumer markets and then expanding into bigger ones, a strategy that would enable the company to enjoy the higher margins that come with brand sales instead of slugging it out as a low-cost supplier to western companies.

Research has shown that the companies in China that are most successful are those that are able to infuse Chinese and western business practices. In joint-venture partnerships both sides are able to draw on the strengths the other has to offer and in this respect Chinese employees are normally very responsive towards any change towards a more western style of management. Chinese employees can be quick and eager to adapt their style of working. It is important to note that this can only be allowed to happen if western partners make a long term commitment to Chinese companies to allow time for the benefits of western style management to be assimilated slowly.



Accounting Profession in China

In China, the accounting profession in China is particularly short on business skills, which really only come from the ability to question and think innovatively, not for questioning sake but for gaining a better understanding of a client's business and therefore their financial needs. The trend of late for Chinese companies to move towards a more western style of management has however led to some accountants being able to question the decisions of senior management and to impart to them the importance of effective budgeting and forecasting.

What's important to note is that the general lack of management skills is not really caused by the lack of a suitable environment in which to exercise such skills, but rather that no formal management accounting courses are offered. Those wishing to become certified accountants in China are limited to only one association offering such a qualification, the Chinese Institute of Certified Public Accountants (CICPA).

Like other stages in the Chinese education system the emphasis in CICPA exams tends to be on rote learning with little or no attention paid to the benefits of budgeting and forecasting. Until recently, most of the major Chinese corporations were state-owned enterprises (SOEs), more answerable to political rather than economic forces. In order to keep these SOEs 'in business', banks in China traditionally met government policy demands by financing their operations with massive loans, regardless of their profitability or risk. Accountants at such SOEs never had to worry about projecting out cash flows.



China's Changing Accounting Regulations

Under China's WTO commitments there is an obligation from five years after entry to treat foreign and domestic companies similarly. A new accounting system was implemented effective from the beginning of 2002. This system is now compulsory for all FIEs in China and brought the Chinese accounting regulations more in line with international Accounting Standards. These changes have represented a move towards higher standards and responsibility to the public for FIEs, but unfortunately a high proportion of local firms are not yet required to be audited. It would seem that there is still a great deal of work to be undertaken to achieve this equal treatment.

The new accounting system saw a paradigm shift towards a principle-based system providing greater flexibility for companies and less strict governance on accounting policies and treatment. This has left a gap however between the accounting system and the taxation system that was previously based on something close to a cash accounting system. Accountants working for FIEs however must now reconcile between international accounting practice, China accounting practice and the tax requirements. Many internal accounting systems in companies in China are geared to producing accounts for the tax man only, not for accounting practice nor internal management analysis.

Unfortunately, the majority of an accountant's time in China is spent on ensuring compliance. Aside from providing information on the performance and position of the business itself, accountants are also generally responsible for a suite of regulatory requirements. As such the ability for accountants to provide extra value to their services is somewhat time constrained. Companies therefore need to upgrade their systems in order to try and simplify the reconciliation work required, which takes time and adds no value to an organization. Accountants must drive this change in order to position themselves in a value-adding role. They need to become more proactive in their efforts to educate senior management of the non-financial aspects of their value. This will in turn help to change perceptions of accounting departments as merely cost centres.

Accountants in China need to try and move towards the role of being a member of decision-making groups within an organisation. They should endeavour to move away from being data creators to being information providers. Key to this is greater understanding of management accounting techniques. Attention needs to be focused on designing and implementing new systems, understanding the organisational concept of accounting and also on the links within the organisation, and finally on developing a closer relationship between those in practice and those in business. The number crunching can be largely automated so freeing up time for analysis, review and assistance in decision-making.



Need for Corporate Governance

For the accounting profession in China there is still along road to be travelled in the areas of corporate transparency and accountability, necessary in order to further accelerate China's move towards a market-based economy. Fair and transparent accounting services are critical to provide good corporate governance, an issue of fundamental importance in China today, where a healthy corporate sector is vital for sustained and shared growth.

The accounting profession in China, already bruised and battered internationally by the likes of WorldCom and Enron, has recently had to deal with it' s own scandals, such as Guangxia Corporation which is accused of fabricating more than \$85 million in profits over three years. One of China's best-known accounting firms was involved in the cover-up and had its licence rebuked as a result. A weak accounting system renders financial information irrelevant and unreliable, jeopardising the quality of decision making by senior management, which would seriously endanger Chinese accountants drive to spearhead a move to increase the overall financial value of their services.

For the Chinese government to stamp out corruption and improve the image of accountants they should consider making it compulsory for all companies to have an annual audit conducted. They should also consider providing more powers to the accounting bodies (both local and internationally recognised) to supervise and protect the profession. Lastly, and most importantly if accountants in China are to develop into true management accountants, they will need to better understand business and how technology can help them move away from their traditional cost and compliance centres. The future in China is about adding value and everyone needs to play their part, both domestic and international accountants.

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CIMA have over 80,000 students and 62,000 members in 155 countries. Its members are "accountants in business" who work in industry, commerce, not-for-profit and public sector organisations and whose key activities are related to business strategy, information strategy and finance strategy. CIMA's focus on management functions makes it unique, and it is internationally recognised as offering *the* financial qualification for business.

CIMA have members and students working in many leading companies throughout China and have recently opened a representative office in Shanghai. For more details please contact Li Ying at: cima_china@sina.com

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