



Accounting & Bookkeeping in China

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1. Introduction:

Financial reporting is an important part of your everyday business and it can explain major aspects of how your company performs and facilitates comparison with your main competitors and industries. Furthermore, modern accounting needs to be able to analyse the financial health of companies in order to better allocate funds and other resources accordingly across an organisation.

Different legislation and accounting standards might vary from one country to another and can influence financial reporting and ratios. There are two major globally recognized accounting standards:

1. International Financial Reporting Standards ("IFRS")
2. US Generally Accepted Standards ("US GAAP")

However while China does not utilise IFRS or GAAP, over the last decade, reform of accounting standards domestically has brought China closer in line with International Accounting Standards. For this reason many of these accounting standards may seem uncommon for many Foreign Invested Enterprises ("FIEs") with cross border interests operating in China. It is important to understand and navigate these differences in reporting, understand the impact within the ratios and your compliance with China Accounting Standards ("CAS" or otherwise known as "PRC GAAP"). By staying informed and up-to-date with the rapid reformation of China's Accounting Standards, an organisation can place its primary focus on growing operations in China.

2. Development of the Chinese Accounting System

Historical Overview

China's accounting system has developed significantly since the economic reforms of 1978 initiated by the Deng Xiao Ping administration.

Prior to 1978, there was no specific accounting system for China. Due to this historical pretext, China had adopted an accounting model similar to the one used in the Soviet Union in order to plan the economy, which in turn was substantially different to the systems developed in the West.

Over the past twenty years, different measurements and the adoption of International Financial Reporting Standards ("IFRS") were taken and eventually People's Republic of China Generally Accepted Accounting Standards ("PRC GAAP") consisting of 16 specific standards was put into force in 2000.

In China responsibility for formulation of the accounting regulations rests with the Ministry of Finance ("MOF"). To develop and implement accounting standards, in 1998, the Ministry of Finance established an accounting standards board composed of representatives from major Chinese enterprises. The purpose of this committee was to provide advice on the overall planning and development of an applicable accounting standard system.

Currently China has undertaken a program to restructure its State-Owned Enterprises ("SOEs") by transforming them into enterprises, which can issue shares and have limited liability, thus forming joint - stock limited companies. Most of these enterprises will in all likelihood eventually go public. A new set of China Accounting Standards ("CAS") was adopted by all listed companies as of 1st January 2007 and is now being phased in over time for all companies. CAS was revised firstly in 2010, and then most recently as of 2014.

Globalization of the Chinese Accounting System

Accounting information is playing an increasingly important role on the exchange markets both domestically and internationally. Inaccurate accounting information can directly affect the quality of the exchange markets and investor confidence. Simultaneously, International Accounting regulations can also negate the language barrier in order to let corporations from different countries exchange financial information. This exchange of information can bring forth investment from new sources and is also useful for companies to compare themselves with their international competitors. More importantly, waste of resources can be avoided, thus improving the efficiency of international trading, reducing the cost of transactions and boosting the development of international trading and investment activities.

Initially the Chinese accounting system was based on compilation of assets owned by a particular company with no measurement of Profit and Loss ("P&L"). This in turn made it challenging for investors to recognise the profitability of an organisation.

While Chinese Accounting Standards ("CAS") is beginning to lean towards more established International Standards, it facilitates companies with an international capital market presence to enter the Chinese market. Companies that follow international accounting standards in the preparation of their financial statements can perceive a lower listing cost on cross border securities issuances. This also ensures the reliability and transparency of accounting information.

However, a high quality accounting standards require more robust and sophisticated management systems within a corporation. When a company in China makes an investment overseas, they can bring with it, a higher standard of management practice in order to strengthen their international competitive power.

Development of China Accounting Standards ("CAS")

Due to the rapid economic growth in China throughout the past 20 years, Chinese Accounting Standards have been developing in order to meet the international market's requirements.

- In 2001 joint stock limited companies offering shares adopted the Accounting Standard of Business Enterprises ("ASBE"). The Accounting Regulations for Selected Joint Stock Limited Companies was subsequently abolished.
- In 2002, Foreign Invested Enterprises ("FIEs") were next to adopt ASBE. The Accounting Regulations for Foreign Investment Enterprises of the PRC were then replaced.
- On 15 February 2005 the Ministry of finance formally announced the adoption of the Accounting Standard of Business Enterprises (ASBEs) which consist of a Basic Standard and 38 specific ASBEs.
- Since 2006, a new "Accounting Standards for Business Enterprises" ("CAS Standards") has been published comprising of 38 specific accounting standards. The accounting standards were updated again in 2014 with three more specific accounting standards issued and five existing accounting standards undergoing revision.
- In November 2009, the government set a target for 2011 that Financial Institutions will be required to prepare all of their financial statements in accordance with IFRS standards.
- In April 2010, the Ministry of Finance made further refinements to ASBE in accordance with revisions made to IFRS.

Furthermore Financial Institutions are also required to prepare another statement utilising CAS standards.

3. Differences between CAS & IFRS & US GAAP

Unfortunately even in light of the recent reforms, the use of International Standards and accounting methods cannot be merged seamlessly with China compliance CAS Standards.

In the below table, some of the key variances between CAS, IFRS & US GAAP are identified taking into account; Presentation of Financial Statements, Consolidation Statements, Fixed & Intangible Assets (eg: Goodwill), Inventories, Deferred Taxes and Equity.

	Chinese Accounting Standard (CAS / PRC GAAP)	International Financial Reporting Standards (IFRS)	US Generally Accepted Accounting Standards (US GAAP)
Introduction	CAS is a set of accounting rules and standards for financial reporting in China	IFRS is a set of accounting rules and standards for financial reporting used in over 110 countries and many other countries are converging to IFRS (including China)	US GAAP is a set of accounting rules and standards for financial reporting used in the United States of America
Performance Elements	Revenue or Expenses Assets or Liabilities, Gains or Losses, Comprehensive Income	Revenue or Expenses Assets or Liabilities	Revenue or Expenses Assets or Liabilities Gains or Losses Comprehensive Income
Impairment of Assets	One-Step Test of Impairment: Once impairment has been recognized it cannot be restored	Two-Step Test of Impairment	One-Step Test of Impairment: once impairment has been recognized it cannot be restored
Estimation of Inventory Cost	Last In, First Out ("LIFO") First In, First Out ("FIFO") Weighted-Average Cost	Last In, First Out ("LIFO") Weighted-Average Cost	Last In, First Out ("LIFO") First In, First Out ("FIFO") Weighted-Average Cost
Inventory Reversal	Prohibited	Can be made over certain conditions	Prohibited
Capitalization of Development Cost	Can be capitalized under certain conditions	Can be capitalized under certain conditions	Prohibited
Depreciation Methods and Expenses	Straight-Line Method Accelerated Methods (for some industries not all)	Straight-Line Method Accelerated Methods Unit of Production Method	Straight-Line Method Accelerated Methods Unit of Production Method
Interest & Dividends Expense	Classified as a Financing Cash Outflow	Classified as an Operating Cash Outflow <u>OR</u> Financing Cash Outflow	Classified as an Operating Cash Outflow
Asset Valuation	Historical Cost	Historical Cost or Fair value for Valuing Assets	Historical Cost Re-evaluation of Assets (under certain conditions)

Impact on Financial Statements & Ratios

All of these differences within the respective Accounting Standards have a significant impact on a company's financial statements and ratios as well as the overall profitability of the company. Management should be aware of these differences in the accounting methods and their impact in order to have a better understanding of the company's financial situation.

Below, some of the key differences between CAS, IFRS and US GAAP are outlined with some practical examples to understand the impact of the variances on the Financial Statements and Ratios.

Impairment of Assets

CAS & US GAAP states that once impairment has been recognised it cannot be restored, while IFRS uses a Two-Step test of impairment. These differences in Accounting Standard between CAS & IFRS could have a significant impact on your balance sheet and ratios as illustrated below:

■ Impact on Balance sheet:

- Long-term assets will be reduced by the impairment
- A deferred-tax category is created (this has an impact on Tax Liabilities)
- If there is an impairment loss or gain, a stockholder's equity will move in the same direction

■ Impact on Ratios:

- A stockholders equity ratio will move in the same direction if there is a gain or loss on impairment
- Return on Assets ("ROA") & Return on Equity ("ROE") will follow the same trend.
- Has an impact on Cash Flow & Liquidity Ratios
- Debt to Assets ratios will follow the same trend as the impairment

Estimation of Inventory Cost:

Inventories are physical products that your company will sell to generate revenue and profit. Inventory costs represent a significant feature on your Balance Sheet. According to Western Standards, inventories occupy a significant part of a balance sheet statement and are considered very high; but due to certain logistical reasons, high inventory ratios are often necessary in China.

Under CAS, IFRS & US GAAP, there are three key methods to report inventories: FIFO, Weighted Average Cost and LIFO (which is not permitted under IFRS). All methods are permitted under CAS, but they all have a different impact on a balance sheet and ratios. The three methods are summarized below:

■ First-in, First-out (FIFO)

This method considers that the oldest goods purchases are sold first and the remaining inventories are the newest. This impacts the balance sheet and ratios in periods of pricing fluctuation. For example in a period of rising price, the cost of your inventory increases faster, because the oldest units sold were assigned a lower cost and vice-versa for period of decreasing price.

■ Weighted Average Cost:

This method considers assigning a Weighted Average Cost to all goods sold and the ones stored in the inventory during your accounting period. It is calculated by compiling the total cost of the units available for sale during the period, divided by the total of units available for sale during the period.

■ Last-in, First-out (LIFO):

This method is only permitted under CAS & US GAAP. It considers that the most recent goods purchased are sold first and those stored in the inventory as the oldest. As a result, the cost of goods sold is more accurate according to the cost of goods purchased. This impacts the balance sheet and ratios during a period of price fluctuation. For example in a period of rising prices, the cost of inventory tends to be lower than the cost of units sold and vice versa for a period of decreasing price.

Example Case Calculation:

Company ABC asked LehmanBrown International Accountants to present them the differences between all methods with focus on LIFO, because it could not be applied under their home regulations.

In 2007 they bought 30,000 units at 12 RMB and sold 25,000 of them at 15 RMB.

In 2008, they bought 50,000 units at 15 RMB and sold 40,000 units at 18 RMB.

Depending on which method used, the final inventories will differ for the period.

The chosen method will therefore have a significant impact on the balance sheet and ratios; highlighting the need to consult an accountant to have a clearer understanding of the financial impact.

FIFO Method	Weighted Average Cost	LIFO Method
225,000 RMB	220,909 RMB	210,000 RMB

Depreciation Method and Expenses:

Long life fixed assets such as property, plant and equipment, buildings, machinery, etc. are assets that are expected to provide your company long-term economic benefits. Usually they represent a significant investment from your part and they have specific accounting Depreciation Method and Expenses rules to be applied.

■ Straight-Line Method:

This method is permitted under CAS, IFRS & US GAAP. This Straight-Line Method is probably the most common approach for many enterprises. It consists of subtracting the expected residual value of expenses divided by its useful life. This method allocates the expense proportionally over the expected lifetime of the assets.

■ Accelerated Method:

This method is fully permitted under IFRS & US GAAP. However under CAS, this method is permitted only if a business is in one of the following industries:

1. Biopharmaceutical Manufacturing
2. Manufacturing of Special Machinery or Transportation Equipment
3. Manufacturing of Electronic Devices
4. Manufacturing of Instruments & Metres, Software Production and Information Technology

This method is similar to the Straight-Line Method, but it allows for allocating greater expenses earlier in the year, which will have a greater impact on financial statements and a company's tax filing.

■ Unit of Production Method:

This method is only permitted under IFRS and US GAAP. Unfortunately, this method is not permitted under CAS, but it is important for an organisation to understand. Furthermore, an organisation's Head Office outside of China might use this method which consists of allocating expenses against the use of assets over a certain period.

■ Example Case Calculation:

If Company ABC purchases new machinery for their factory in Tianjin. The cost is 100,000 RMB and has a residual value of 1,000 RMB over 5 years. Production is expected to be 2,000 units for the first two years and 3,500 units in the final three years. (For the Accelerated Method: Assume that it is applied at 20%)

Straight-Line Method	Accelerated Method	Unit of Production Method
19,800 RMB	23,760 RMB	12,655 RMB

Depending on which method a company uses, the depreciation expense may vary and this will have an overall effect on a variety of financial statements and ratios (Fixed & Total Asset Turnover, Operating Profit Margin, Operating Return on Assets and Return on Assets). It is important to note that over the 5 year period, the same amount will have been recorded as expenses, however depending on a company's specific requirements one particular method may enable tax savings and an increase in profitability. Choosing the appropriate Depreciation Method therefore is a key consideration.

Interest & Dividend Expenses:

Interest & Dividends expenses appear on the Cash Flow statement. In this statement, cash flow is classified by three categories:

- Operational Activities
- Investment Activities
- Financing Activities

These classifications have a significant impact on the financial statements and ratios of a business. However according to the various accounting principles, expensed interest should be classified as financing outflow under CAS, while under US GAAP it has to be classified as operational cash outflow. IFRS provides a more flexible way of presenting interest & dividends expenses as operational or investment categories.

Asset Valuation:

Long-term assets play a significant role in an organisation's 'Real' & 'Book' values. There are two methods for conducting a valuation on long-life fixed assets and the use of one or the other will have a significant impact on the book values.

Under CAS & US GAAP, only the historical cost can be compounded as the value of an asset, whereas under IFRS, both historical cost & re-evaluation methods are allowed. However, you cannot use both methods in tandem.

■ Historical Cost:

The book values are carrying amounts under historical cost (purchase cost) and deduct accumulated depreciation & amortization.

■ Re-Evaluation Method:

This method is more costly, because it necessitates a constant re-evaluation of your assets. The book value is the fair value of the last re-evaluation minus the accumulated depreciation & amortization.

According to the CFA institute, one key difference between the two models is that the cost model allows only decreases in the values of long-life assets, however the re-evaluation model may result in an increase in the values of long-life assets to amounts greater than the historical cost.

4. Tax Filing

Online & In Person

In order to file a company's books with the Local Tax Bureau ("LTB") in China, LehmanBrown uses the Yongyou ("UFIDA") accounting software system. UFIDA is the largest and most common accounting software system used in Mainland China and we use this alongside our own system, which can enable simple inputting into SAP or Oracle systems if required to report overseas

In Mainland China, tax filings are conducted online via a software system provided by the tax bureau which is installed on a designated workstation within a company. A company will then be assigned specific log in credentials to access the system and process CIT filings

Fapiao Invoice

From our experience, those without an understanding of the Chinese accounting system underestimate the importance of the Fapiao invoice and can find it confusing. A Fapiao is not only a tax receipt, but is also a bill and an invoice which is used to support contracts & warranty.

Even if a company is not required to declare revenue in China, the Fapiao is a key form of documentation for transactions. It is a means for the government to both detect and monitor tax evasion; and it provides a business with the actual record of an amount paid for goods and services.

For reimbursement on any travel expenses, a Fapiao should be used as an official receipt and submitted accordingly by the claimant.

A Fapiao can be requested from any business in China, although one should keep in mind that most companies in the interest of avoiding tax will try to give you a regular receipt ("shouju") instead.

We recommend you to always request a Fapiao, so you can earn tax breaks at the end of the financial year.

5. In Summary

As China modernises its accounting system and with a fast evolving accounting sector, it can prove difficult for many firms to keep on top of new legislation and accounting standards.

Accounting & Bookkeeping standards differ from one country to another, even though most countries Generally Applied Accounting Principles ("GAAP") have been modified to be in compliance or similar to International Financial Reporting Standards ("IFRS"). However there are still many countries that operate within their own GAAP regulations.

China's Accounting Standards (known as "CAS" or "PRC GAAP") have remained largely autonomous from globally recognized principles and thus providing cross-border businesses and multi-national ("MNCs") businesses with a challenge when ensuring compliance to the principles used in their Head office jurisdiction. For example, there are different rules for impairment of assets, inventory costs & reversal, capitalization of development costs, depreciation expenses, interest & dividend expenses and asset valuation. Those different methods can have an impact on your business ratios, profitability and tax burden. It is therefore imperative for a foreign invested enterprise to have a clear understanding of CAS and the variances between CAS and other global standards



About Us

Founded in 2001, LehmanBrown is a China-focused accounting, taxation and business advisory firm, operating in Beijing, Shanghai, Hong Kong, Macau, Shenzhen, Guangzhou and Tianjin. Our firm also manages an extensive affiliate network, providing service throughout China and reach across the globe.

Combining years of international expertise with practical Chinese experience and knowledge, LehmanBrown offers expert advice and support to both local and international clients. Within the mid - tier, we are regarded as a market leader and our clients enjoy access to a combination of senior and experienced counsellors from both China and abroad.

At LehmanBrown we recognise that you are unique, that you have unique requirements and we are committed to providing individually tailored financial solutions. LehmanBrown is dedicated to providing personalised service by working closely with our clients to understand your individual business needs. This enables us to offer the most up-to-date and expert advice.

关于我们

雷博国际会计成立于2001年，是一家获得许可，主要从事有关中国范围内会计、税务和财务咨询服务的公司，在北京、上海、香港、澳门、深圳、广州和天津设有专门办事机构，正积极在全国范围内建立广泛的联合专业服务网络。

综合多年的国际经验和对中国市场的深刻理解和实践体验，我们向广大国内外的客户提供高质量的专业服务和意见帮助。在雷博国际会计的服务过程中，我们作为市场中的佼佼者，您将得到来自中国本土以及其它国家的高级资深专家热忱的咨询帮助。

我们深刻认识到每一位客户都是独一无二的，并都有其独特的业务需求。雷博国际会计承诺将根据客户的不同业务需求，为客户提供个性化的财务解决方案。我们的专业人员将密切与您合作，以充分了解您独特的业务需求，从而提供满足您所需要的高时效、高质量的专业服务。

Professional Services

Audit & Assurance

External Audit

China Statutory Audit

US GAAP Audit

IFRS Audit

Hong Kong Statutory Audit

Internal Audit

Fraud Investigation

Forensic Accounting

Special Purpose Audit

Foreign Currency Audit

Royalty Audit

Capital Verification Audit

Valuation Services

Corporate Valuation

Damage Assessment Valuation

Intellectual Property Valuation

Asset Valuation

Special Purposes Valuation

Corporate Finance

Debt Restructuring

Acquisition, Disposal & Financing

Mergers & Acquisitions

Transaction Advisory

M&A Divesture

M&A Integration

Financial Due Diligence

Business Services

Company Registration & Maintenance

Market Entry Advisory

Updating Company Certificates

Annual Inspection & Reporting

Company Secretarial Services

Company Ownership Transferring/Corporate Restructuring

Background/Credit Checking

Company Deregistration & Bankruptcy

HR Support Services

China Visa Services for Expatriates

Social Welfare Structures

Outsourcing Services

Accounting & Bookkeeping

Budgeting & Forecasting

Financial Statement Preparation

Head Office Reporting

Financial Management

Interim Financial Management

Finance Manager Function

CFO Function

Cash Flow Management

Treasury Management

Set-up of Bank Account

Payroll Services

Payroll Processing Setup

Expatriate Employees

Local Employees

Secondment & Temping Services

Chop Custodian Services

Taxation Services

Individual Tax Planning (IIT)

Tax Immigration & Investment Review

US & Overseas Personal Income Tax Planning & Filing

IIT Tax Payment Facilitation

Application for Individual Income Tax Refund

Expatriate Staff Individual Income Tax Staff Filing

Local Staff Individual Income Tax

Company Taxation (CIT)

Tax Consulting

Corporate Tax Planning

Business Restructuring

Value Chain Review

Onshore / Offshore Investment

Transfer Pricing

Tax Compliance

Tax Due Diligence

Tax Deregistration

Negotiation of Tax Penalties

Tax Refund Application

Tax Representatives for Tax Audit

VAT & Customs Duty Clearance

PRC Tax Receipt Verification

VAT Application

VAT & Sales Tax Filing

Corporate Income Tax Reporting

Specialist Accounting & Risk Management

Internal Controls

Systems

Risk Management

Sarbanes - Oxley (SOX 404)

GAAP, SEC & IFRS Compliance

US GAAP

US GAAP Financial Statement Preparation

US GAAP Conversion

Other GAAP

GAAP Conversion

Public Company Compliance

Financial Statement Preparation

IFRS

IFRS Accounting Repackaging

IFRS Financial Statement Preparation

IFRS Public Company Compliance

SEC

SEC Public Company Compliance

Legal Services

Legal Advisory

Labour Legal Advisory

Workforce Downsizing Advisory

Labour Tribunal Assistance & Advisory

Labour Law Review & Audits

Review & Preparation of Employment Contracts

Corporate Legal Advisory

Legal Due Diligence

Corporate Restructuring Advisory

Review & Preparation of Articles of Association (AoA)

Review & Preparation of JV Contracts

Review & Preparation of Repatriation Agreements

Other Legal Services

Dispute Mediation & Advisory

Trademark & Intellectual Property Advisory

Debt Collection Assistance

Litigation Support

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For further information about how we can add value and support your individual or business needs, please contact us.

如需为个人或企业获取更多的增值服务及业务协助信息，请与我们联系。

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