China: A Brief on the Institute's Study Tour*

A tour to undertake study of the professional and university education system, banking and insurance industry, capital market regulations, stock market mechanism, etc. in China was organised by the Institute from 24th November to 3rd December 2004. The delegation, including members of the Institute holding senior positions in Indian enterprises and in practice, had interaction with the respective Chinese authorities. The study tour has brought out dimensions of relevance to professionals particularly the accounting service providers, which are shared for information.

China's economy has witnessed rapid and stable development over recent years, with its GDP having reached 10,200 Bn Yuan (US$1 = 8.2-8.3 Chinese Yuan). Relevant expression of its economic growth mechanism include further reduction of market entry thresholds; relaxation of government regulation; improvement of investment and financing environment; perfection of legal environment and effective use, efficient circulation and reasonable distribution of market elements.

China has established a new philosophy of development for its economic growth, i.e., transforming from exclusive pursuit of GDP growth to the mandate of increase in wealth and optimization of economic functions. Such a sound macroscopic economic environment and momentum of development surely contains greater market opportunities including those existing in the accounting market. The salient features of their journey of reform process were detailed, inter alia, by the Office of Consulate General of India and it was brought to the fore that

- In spite of transformation from central economy to a market-oriented economy over the last 20 years, the pattern of governance is still monolithic in nature.
- Decision-making at local level provides latitude for large investments. Relatively
- authoritative system has so far proved to be critical factor in the economic progress.
- Possibly the usage of single language and homogeneity in culture and environment is a key determinant in the success of the Chinese economy.
- Transition to *laissez faire* economy.
- China is a classic case study of privatization versus decentralization.
- Saving ratio in urban areas has risen from around 20% in 1998 to reach 30 % at present.
- China has established large holding companies to look for financial partners for pumping FDI and rehabilitation of sick enterprises.

Structure of Professional Education System -

Established in 1988, the Chinese Institute of Certified Public Accountants (CICPA) is the professional accountancy body in China. CICPA conducts examination, establishes auditing and regulatory standards, administers disciplinary mechanism, ensures continuous professional development and also maintains dialogue with international bodies. CICPA has 130,000 members out of which 60,000 members are in practice while 70,000 members are engaged otherwise. CICPA is like a federal head with each Chinese province having a CPA Institute, which though autonomous, has its routes aligned to the central Institute. China's Independent Auditing Standards of the Certified Public Accounts (CIASs) are formulated by CICPA and approved by the Ministry of Finance. The structure of CIASs consists of General Independent Auditing Standard, Specific Independent Auditing Standards and Auditing Guidelines. CICPA has also issued the 'General Standard on Professional Ethics', 'General Standard on Quality Control' and the 'General Standard on Continuing Professional Education'.

Accounting Standards in China are formulated by the Ministry of Finance, People's Republic of China. The framework of accounting standards in China consists of a basic standard and a series of specific standards. The basic standard, which prescribe the accounting assumptions and general principles of accounting, accounting elements and the general requirements for the preparation and presentation of financial statements, was implemented in 1993. The specific standards are formulated in consonance with the basic standard. Hitherto 16 specific standards have been formulated, out of which seven specific accounting standards are applicable to all enterprises while nine specific accounting standards apply only to listed companies or joint stock limited companies.

The Chinese government has established Shanghai National Accounting Institute (SNAI) to further the knowledge and abilities of CPAs and senior financial managers to nurture their accounting skills with the new accounting requirements and strategic perspectives, as the erstwhile accounting practices adopted during the period of socialist economy could not catch up with the present day requirements of a market driven economy. The Institute's campus spans 34.67 hectares and boasts of world class teaching facilities, designed according to international standards for CPE and targets at establishing a "senior-level, international and e- technology" continuing education base and also provides finance and accounting education to public through Internet and facilitates research. The average number of students that undergo training in a year is 20,000. Its website, www.eSNAI.com, is one of China's primary channels for disseminating accounting information.

Banking Industry

The supervision of all Financial Institutions in China including banks, insurance enterprises and other financial service companies fall within the realm of the China Banking Regulatory Commission (CBRC). Prior to its inception, the responsibility to regulate the industry was vested in the People's Bank of China. CBRC maintains a Credit Information Exchange Bureau on credit worthiness of customers and shares this information with banks.

Since CBRC's establishment, there has been a considerable containment in the Non-Performing Loans (NPLs) of banks. The average NPLs of four major banks have been reduced from 26% in 2001 to 15% in 2004. The following measures have been adopted to render strength to the Chinese banking system:

- Improvement in accuracy of the assessment of quality of assets w.r.t. best practices in the world to identify risks in a timely manner.
- Adequate provisioning in respect of doubtfulness of assets.
- Increased corporate governance and effective internal management and controls.
- Average Capital Adequacy Ratio (CAR) across the sector is 8%. Due to the measures adopted, CAR is likely to improve significantly.
- Basel II recommendations may not be adopted by 2006 as the present restructuring process has just been initiated. Adoption of the said recommendations could be considered based upon the experience of the exercise.

In the first stage of banking reforms in China, the organization was transformed into four specialized banks catering to the specific economic needs. During the second stage, which commenced by the end of 1980s, the four specialized banks were transformed into state-owned commercial banks. In the ongoing third stage, the state-owned commercial banks are being transformed into Joint Stock Companies by accessing the markets through Initial Public Offers and/or introduction of strategic investors. During the financial restructuring process, strategic investors will be considered to be introduced indigenously as well as from abroad with their stake being limited to 20% individually and 25% in the aggregate.

Insurance Industry

The Chinese insurance industry, still in a very primitive stage, is regimented by the China Insurance Regulatory Commission (CIRC).

- Total assets owned by the insurance companies - $140 Bn
- Total income for last year - $47 Bn
- Number of insurance companies - 70 (30 life and 40 non-life insurance companies)
- Maximum foreign investment - 25%.
- Modes of investment by foreign insurance company – (i) Joint Venture (ii) as a Branch (iii) solo foreign company.
- Insurance premiums in China grew a sizzling 45 per cent in 2002, but slowed to 27 per cent in 2003 and rose to 13.7 per cent in the first ten months of 2004 to more than US$ 40 Bn.

The move allowing foreign players into the three non-life businesses comes two years ahead of an original deadline of end-2006; agreed to when China joined the WTO in December 2001 after a decade of wrangling.

Accounting Regulatory Department, Ministry of Finance

As elucidated earlier, the accounting standards in China are formulated by the Ministry of Finance, People's Republic of China. However, unlike India, the audited accounts of companies are not in public domain and have to be specifically requested from the Ministry of Finance.

Capital Markets

China Securities and Regulatory Commission (CSRC), established in 1992, is the national securities market regulatory authority in China. The number of listed companies in China has risen from 10 in 1990 to 1287 in 2003; capital mobilized during 2003 amounted to 118 Bn Yuan. CSRC's recent focus is on developing investment funds and other institutional investors.

CSRC supervises direct or indirect overseas offerings and listings by domestic enterprises, operation of the domestic institutions and operation of the securities market intermediaries in China by overseas institutions. CSRC is also responsible for licensing, in conjunction with relevant authorities, of accounting firms, asset appraisal firms and employees thereof to engage in certain securities and futures intermediary businesses and supervision of such businesses.

There are two stock exchanges in China – Shanghai Stock Exchange (SSE) and the Shenzhen Stock Exchange. These exchanges are non-profit-making, self-regulatory statutory entities and provide a forum for centralised trading of securities in China. The study tour visited the Shanghai Stock Exchange, established in 1990, and found that it operates through a paperless trading mechanism and features a maximum daily execution capacity up to 29 million orders, settling 60 million transactions at a pace of 15,000 transactions/ second. Total market capitalization of SSE, at the end of December 2003 amounted to 2,980.5 Bn Yuan, about 27 percent of the China's GDP. The Exchange has registered investors' base of about 36.32 Mn and 177 members. About 800 companies are listed on this Exchange. SSE also supports the securities research initiatives jointly with other research institutes, some of which have become the "Brain Cabinet" of the national securities market.

Taxation System

The State Administration of Taxation (SAT) under the State Council is in charge of revenue work. SAT's mandate includes drafting of tax laws and regulations, formulation of detailed implementation rules, tax policies, measurement of overall tax burden and putting forward suggestions on usage of tax collections, organising collection and administration for central taxes, providing interpretation thereon, working out revenue plans, conducting international exchange and cooperation on taxation, negotiating and applying agreements on avoidance of double taxation and prevention of tax evasion, organising theoretical research and activities to promote tax awareness, etc. The total tax revenues in 2003 were 2,046 Bn Yuan; in 2002, 1,700 Bn Yuan and in 2001, 1,516 Bn Yuan.

HIGHLIGHTS OF THE TAXATION SYSTEM IN CHINA ARE:

- 26 kinds of taxes classified into following seven categories:
  - Turnover Taxes
  - Income Taxes
  - Resource Taxes
  - Property taxes
  - Taxes for special purposes, including City Maintenance and Construction Tax, Fixed Assets Investment Orientation Tax, Land Appreciation tax and Vehicle Acquisition Tax
  - Behaviour taxes, including Vehicle and Vehicle Usage Tax, Vehicle and Vehicle Usage Plate Tax, Vessel Tonnage Tax, Stamp Duty, Deed Tax, Slaughter Tax and Banquet Tax
  - Agricultural taxes
- Shared system of revenue - 75% of the tax revenue retained by Central Government and rest apportioned among local governments.
- Individual income taxed at slab-rates ranging from 5% to 45%. Foreign citizens working in China entitled to genuinely beneficial special rebates and deductions.
- Enterprises taxed at 33%. Foreign enterprises and enterprises with foreign investment entitled to special deductions enabling them an effective tax rate vis-à-vis local companies/enterprises.
- Excise Tax on only 11 commodities
- 50% of the revenues is derived from VAT
- Transfer Pricing – OECD model followed
- Service Tax levied @ 5%. Some services taxed @3%
- Simple Tax laws with 50 articles and about 25 sections.

China follows a Certified Taxation System wherein the tax agents need to be registered and work according to the system set by the government. Such certified tax agents (CTAs) represent tax issues before SAT on behalf of their assesses and can also take up auditing and accounting assignments. To obtain the certificate of CTA, graduate-applicants must qualify the examination organised nationwide on an annual basis in 5 subjects. CPAs are offered some exemptions in the examination. Currently, there are 62,000 tax agents in China, of which more than 20,000 are tax practitioners, the rest being not tax-practitioners. Though presently, residency and citizenship criteria apply, the system is likely to change post-WTO.

The Study Tour observed the giant strides made by China in their process of economic reforms and it can be said that for fruitful trade relations with China, India should move up the value ladder from low value to high value service provider.

Some of the **significant outcomes** of this visit on which work is underway:

- Further strengthening of relations between the two accounting bodies
- Setting up of dedicated technical desk at both the Institutes in respect of professional avenues for usage by members of both Institutes.
- Possible collaboration for on-line Continuing Professional Educational Programmes
- Sharing of resources and expertise in post qualification courses, peer review and financial reporting & review mechanism.
- Joint international conference in India /China in near future.
- Widening of professional opportunities.

CICPA has been invited to organise a study tour to India on reciprocal basis consisting of similar set of functionaries and authorities to carry forward the exploration studies of Financial Systems and providing lead to professionals at both ends to make professional headways.

**Prepared by Rakesh Sehgal, Joint Secretary, ICAI. Further details on the study tour are available at the Institute's website: www.icai.org* ■

ICAI WELCOMES THE NATIONAL TAX TRIBUNAL BILL, 2004

The Institute of Chartered Accountants of India, compliment Mr. H.R Bhardwaj, Union Minister for Law and Justice yet another structural reform in the administration of the tax laws, by introducing the National Tax Tribunal Bill, 2004. The Institute has all along advocated the need for the constitution of a National Tax Tribunal to act as an apex tribunal for the resolution of disputes in tax related matters, direct as well as indirect. A highly specialised tribunal at the national-level exclusively devoted to the adjudication of disputes with respect to direct taxes as well as indirect taxes would not only result in increase in the collection of the revenue but also expedite the process of adjudication. This would not only relieve the assessees from the burden of pursuing the tax disputes for a very long period but would also substantially relieve the work load of the High Courts.

The Institute, however, feels that the composition of the National Tax Tribunal as proposed in the Bill for the persons with the judicial background or those having experience of the Income-tax Appellate Tribunal need to be reviewed to make it more broad-based. In order to ensure expeditious disposal of the disputes it is also necessary that the Tribunal does comprise of persons who have the knowledge, experience and expertise gained out of public practice of the tax laws. The Institute, therefore, has suggested to the Hon'ble Minister to provide that the members of the profession in practice for stipulated number of years should also be eligible for appointment as members of the NTT.

The entire profession as well as the ICAI are very much concerned with the provision of clause 13(2) which does not allow the chartered accountants to present the case before the National Tax Tribunal on behalf of the Central Government. This is not logical since the chartered accountants are allowed to present the case of the assessees before the NTT.

The Institute in its representation to the Government has sought to amend the Bill to enable the chartered accountants also to present the case before the NTT on behalf of the Government.