1 of 3 DOCUMENTS

Emerging Issues Copyright 2010, Matthew Bender & Company, Inc., a member of the LexisNexis Group. All Rights Reserved.

Hibbert and Hsieh on China's New Food Safety Law

2009 Emerging Issues 4644

Hibbert and Hsieh on China's New Food Safety Law: An American Perspective

By Robert Hibbert and Grace Hsieh

November 30, 2009

SUMMARY: Chinas new Food Safety Law, enacted in February 2009, is a significant and necessary document, whose application will have consequences far beyond Chinas own borders and into the United States and other world markets as well. The full extent of its impact, however, will be determined by a host of factors, many of which go beyond a simple examination of its text.

PDF LINK: Click here for enhanced PDF of this Emerging Issues Analysis at no additional charge

ARTICLE: Hibbert and Hsieh on China's New Food Safety Law

Robert G. Hibbert and Grace Y. Hsieh, K&L Gates LLP

China's new Food Safety Law, enacted in February 2009, is a significant and necessary document, whose application will have consequences far beyond China's own borders and into the United States and other world markets as well. The full extent of its impact, however, will be determined by a host of factors, many of which go beyond a simple examination of its text.

While it is taken as a given within the trade, it is highly unlikely that most members of the general public have a clear appreciation of the extent to which food production and marketing have evolved into a global enterprise. Of the 1,800 pounds of food eaten by the average American every year, n1 approximately 260 pounds of it is imported, n2 entering through over 300 ports from over 150 countries. n3 It is estimated that 15% of food in the United States is imported. n4 3.3% of the food purchased in the United States comes from the People's Republic of China (PRC). n5 Agricultural and seafood imports from all countries have increased by 50%, 350% for China, within the past decade. n6 The number of foreign firms registered with the Food and Drug Administration (FDA) for imports is over 200,000, n7 and these numbers have been increasing steadily over the last 10 years.

American consumers enjoy enormous benefits from such a system. The food supply at their disposal is abundant, affordable and increasingly varied. But with such benefits come inevitable costs, including an increased erosion in the confidence of the safety of imported food. The American regulatory system is attempting to deal with the issues and questions raised by such globalization. n8 Such issues were largely not envisioned by a legal and regulatory structure essentially enacted over a century ago. At a recent presentation, David W.K. Acheson, M.D., F.R.C.P., the Associate

Commissioner for Foods in the FDA, indicated that the challenges to safeguarding imported foods are due, in part, to the wide variation in practices, lack of clear preventive controls, the national distribution systems (e.g., outbreaks of contaminated product in multiple states from a single source), lack of enforcement, and erosion of the public health infrastructure to investigate outbreaks. n9

Several recent high-profile incidents have caused such concerns to accelerate. For example, the Salmonella Saintpaul outbreak in 2008, which FDA scientists initially associated with the tomato industry and then with hot peppers, resulted in over 1,450 illnesses and generated international headlines. In 2008-2009, a Salmonella Typhimurium outbreak in September 2008 was ultimately traced to peanut products in January 2009, resulting in protracted and extensive recalls. These incidents reveal slow identification of the food vehicle, lack of preventive controls, inability of FDA to review records, and inefficient product tracing.

The current Congress has stated its intention to make the safety of the United States' food supply a major focus, and legislation to introduce new requirements for imports to ensure their safety is actively being considered. In April 2008, the House Energy and Commerce Committee released a discussion draft of legislation entitled the Food and Drug Administration Globalization Act of 2008. As drafted, it would require new procedures for imported foods. These would include requiring food to enter the United States only through a port of entry that is located in a metropolitan area with a federal food-testing facility unless each facility that has manufactured, processed, packed, and held the food is certified to be in compliance with FDA food safety and security guidelines. The FDA Food Safety Modernization Act was introduced on March 3, 2009. If enacted, the legislation would require importers to verify the safety of foreign suppliers and imported food. The legislation also would allow the FDA to require certification for high-risk foods and to deny entry to a food that lacks certification or that is from a foreign facility that has refused U.S. inspectors.

Regardless of whether these particular federal efforts to improve traceability and accountability are eventually passed into law, it is clear that the Congress and FDA are currently focused on enhancing the existing regulatory framework to better ensure the safety of imported foods. On January 12, 2009, several agencies issued a Draft Guidance on Good Importer Practices. The Guidance was issued jointly by the FDA, the United States Department of Agriculture, the Consumer Product Safety Commission, the Environmental Protection Agency, the Department of Commerce, the Department of Homeland Security, the Department of Transportation, and the Office of the United States Trade Representative. Among other things, it recommends that companies establish several formal programs, covering product safety management, vendor and supplier compliance verification, and corrective and preventive actions. While not legally binding in a direct fashion, such guidance materials do reflect regulatory intent. And notably, in the food area, such intent is being backed by increasing congressional appropriation targeted at import safety enforcement.

The private sector is hardly unaware of, or indifferent to, such developments. To the contrary, within the current environment of outbreak, recall and enforcement, customers are dramatically increasing their self-protection efforts. This manifests itself in a growing reliance upon enhanced guarantees, indemnification requirements, audit provisions, traceability mandates, and other contractual provisions.

The new Chinese Food Safety Law, adopted February 28, 2009, reflects a significant effort to respond to these concerns. Obviously, in both the Chinese and the American context, the most tangible driver for reform was the substantial and tragic consequences of the melamine incident. The PRC Food Safety Law, which goes into effect on June 1, 2009, includes provisions to improve traceability and accountability of food companies. The law seeks, among other things, to establish a national food safety standard and consolidate the standards (Articles 18-26); to establish a food safety risk monitoring system (Article 11); to adopt a licensing system for food production and business operations (Article 29); to establish a certification program for enterprises with good manufacturing practices (GMP) and hazard analysis and critical control point systems (HACCP) (Article 33); to require verification of a food supplier's license and product compliance certifications and to establish recordkeeping requirements as to the food, its ingredients, and the suppliers (Articles 36-39); to establish a licensing system for food additives (Article 43); to establish a record system for exported foods (Article 69); and provides for various inspection and recordkeeping procedures vis-[agrave]-vis issuance of licenses, inspection results, investigation and handling of unlawful conduct, etc. so as to bolster the government's

ability to enforce and uphold the law (Articles 76-83). These provisions dovetail what is being insisted upon in the U.S. regulatory system and are a significant advancement in Chinese law to protect the safety of food.

Without question, such measures are a significant step forward. They reflect a clear recognition on the part of the Chinese government of both the magnitude of the problem and of the type of framework needed to address it. The law as written gives China a clear foundation for compliance with emerging requirements in the United States and elsewhere, regardless of the ultimate form they might take.

The critical question, of course, is what is to be built upon such a foundation. If a licensing system is to be established, what are the relevant criteria? How are such laws to be enforced? Will there be adequate government oversight and will government personnel be adequately trained?

These are not criticisms of the law itself as written. Similar questions are left unresolved, for example, in an examination of the Federal Food, Drug and Cosmetic Act as well. In the end, it is never all that difficult to draft a new law and to fill such a document with a host of goals and aspirations. The more difficult and critical question involves the degree to which they ultimately are or are not reached.

Given the current policy environment in the United States, China's passage of this legislation is exceedingly well-timed. In the wake of the melamine incident as well as broader concerns regarding import safety, its credibility in this area has been weakened, and Americans, like other consumers worldwide, have become more skeptical. Under such circumstances, if the law can be implemented efficiently, effectively and persuasively, there is every reason to believe that China will be ideally positioned to enjoy growing access to the lucrative American market and also to accelerate its development as a global leader within the food trade.

Return to Text

n1 How We Eat, Rural Migration News, October 1996 Vol. 2, No. 4, available at http://migration.ucdavis.edu/rmn/more.php?id=158_0_5_0 (last visited May 8, 2009).

n2 Bridges, Andrew, Imported Food Rarely Inspected, USA Today (posted Apr. 16, 2007), available at http://www.usatoday.com/news/nation/2007-04-16-imported-food_N.htm (last visited May 8, 2009).

n3 David W.K. Acheson, M.D., F.R.C.P., the Associate Commissioner for Foods in the FDA, Presentation on Globalization of the Food Supply -- Time for a Change in Approach, at the FDLI & FDA 52nd Annual Conference (Apr. 22, 2009), available at http://www.fdli.org/handouts/74/ (last visited May 8, 2009).

n4 Id.

n5 Bridges, supra note 2.

n6 Caroline Smith DeWaal, Director of Food Safety, Presentation on Imported Food: USDA's Options for Change Limited by 1906 Statute and Consumer Confidence, August 27-28, 2008, available at www.fsis.usda.gov/OPPDE/nacmpi/Aug2008/11-SmithDeWaal.ppt

n7 Acheson, supra note 3.

n8 According to a report from Public Citizen, a non-profit public interest organization, nearly $65 billion in food goods are imported into the United States annually, the FDA estimates that it will only conduct border inspections on 0.6 percent of the food that it regulates (vegetables, fruit, seafood, grains, dairy and animal feed) at the border in 2007, and only 11 percent of beef, pork and chicken imported so far in 2007 has been inspected at the border by the United States Department of Agriculture (USDA). See "Trade" Agreements Undermined Food and Product Safety, Public Citizen, Global Trade Watch, available at http://www.citizen.org/trade/food/ (last visited May 8, 2009).

n9 Acheson, supra note 3.

PDF LINK: Click here for enhanced PDF of this Emerging Issues Analysis at no additional charge

ABOUT THE AUTHOR(S):

Robert G. Hibbert, Partner, K&L Gates LLP

Prior to joining K&L Gates, Mr. Hibbert was a partner with a leading Washington, D.C. law firm. He formerly served as a senior attorney with the U.S. Department of Agriculture, and subsequently directed the USDA's standards and labeling staff, formulating policy in areas including food safety, product standards and nutrition labeling. He also held the position of Vice President and General Counsel with the American Meat Institute.

Mr. Hibbert's practice focuses upon federal regulation of the food and agricultural industries, with emphasis upon USDA. Areas of particular concern include food safety, food security, animal health, biotechnology, labeling, advertising, and new product development.

Grace Y. Hsieh, K&L Gates LLP

Information referenced herein is provided for educational purposes only. For legal advice applicable to the facts of your particular situation, you should obtain the services of a qualified attorney licensed to practice law in your state.

2 of 3 DOCUMENTS

Emerging Issues Copyright 2009, Matthew Bender & Company, Inc., a member of the LexisNexis Group. All Rights Reserved.

Lazo and Massari on Taxation of Capital Gains in Peru

2009 Emerging Issues 3288

Gustavo Lazo and Georgio Massari on Taxation of Capital Gains in Peru

By Mr. Gustavo Lazo Esq. and Mr. Giorgio L. Massari Esq.

March 4, 2009

SUMMARY: The taxation of capital gains resulting from the transfer of securities in Peru is on the brink of change. Legislative Decree 972, in force as of January 1, 2009, intends to modify the past regime repealing the long standing income tax exemption to this type of capital gain. In this commentary, Gustavo Lazo, a partner in Estudio Olaechea and his associate Giorgio L. Massari Figari discuss the recent enactment of the law and its implications.

PDF LINK: Click Here for Enhanced PDF of Commentary

ARTICLE: The taxation of capital gains resulting from the transfer of securities in Peru is on the brink of change. The long standing income tax exemption on this sort of capital gain has aimed to provide the necessary encouragement for investors.

Nevertheless, Legislative Decree 972 (LD), published in the Official Legal Gazette on the 10th of March, 2007, into force as from the 1st of January of 2009, intends to modify this regime. Not only will the referred exemption be repealed, but other changes to the taxation of capital gains in Peru will also occur.

However, meanwhile, a bill has been presented for approval before Congress by the Executive Power in order to postpone the entry into force of the LD to the 1st of January of 2010. This is a response to the current financial crisis affecting capital markets worldwide.

Income Tax of Domiciled Individuals. The capital gains obtained by individuals due to non-habitual transfer of securities are considered as second category income, as stated by paragraph j) of article 24 of the ITL n1

However, according to part 1 of paragraph l) of article 19 of the ITL, the capital gains obtained by individuals resulting from the transfer of securities registered in the Public Registry of the Stock Market carried out through centralized negotiation mechanisms (within the Lima Stock Exchange) are exempted from the Income Tax until the 31st of December of 2008.

Likewise, according to the same disposition, the capital gains obtained by individuals resulting from the transfer of securities not carried out through centralized negotiation mechanisms are also exempted from the Income Tax until the 31st of December of 2008.

Notwithstanding, the LD will abolish paragraph l) of article 19 of the ITL. Therefore, on the 1st of January of 2009, the capital gains obtained by individuals resulting from the transfer of securities registered in the Public Registry of the Stock Market whether they are carried out through centralized negotiation mechanisms or not, will no longer be exempted from the Income Tax.

Likewise, the LD has modified the way to calculate the Income Tax of an individual. When the modifications made by the LD enter in force, the second category gross income will be added with the first category gross income (i.e. derived from the lease of assets). To the sum of these, a deduction of 20% will be allowed in order to determine the net income. Finally, the said net income will be levied with a rate of 6.25%, which is the same as 5% over the gross income.

It is important to point out that capital gains will be considered as third category income (business income) when an individual is considered to habitually carry out the transfer of shares and participations representative of capital and other securities. Note that the corresponding net income will be levied with a rate of 30%.

The individual will be considered to habitually carry out the transfer of shares and participations representative of capital and other securities when at least ten (10) acquisition transactions and ten (10) sale transactions are made during a fiscal year. For this purpose, regarding the securities listed in the stock market, only one operation will be considered to have occurred when an order is given to an agent to acquire or sell a certain number of securities, even if the agent carries out many operations to complete the number of securities that the principal orders to buy or sell.

The following operations will not be considered in order for an individual to be deemed to habitually transfer shares and participations representative of capital and other securities: (i) fiduciary transfers that are not deemed transfers for Income Tax purposes; (ii) operations made in order to benefit the taxpayer through an autonomous patrimony which individual performance will be established in relation to collective results (Mutual Funds of Investments in Securities, Investments Funds, and others); and (iii) the transfer of assets when these have been acquired by cause of death.

Income Tax of Non-Domiciled Individuals. According to part 1 of paragraph l) of article 19 of the ITL, the capital gains obtained by individuals, resulting from the transfer of securities registered in the Public Registry of the Stock Market carried out through centralized negotiation mechanisms are exempted from the Income Tax until the 31st of December of 2008.

Likewise, according to the said paragraph, the capital gains obtained by non domiciled individuals resulting from the transfer of securities outside of the centralized negotiation mechanisms are also exempted from the Income Tax until the 31st of December of the present year.

Notwithstanding, the LD will abolish paragraph l) of article 19 of the ITL. Therefore, since its enforcement on the 1st of January of 2009, the capital gains obtained by individuals resulting from the transfer of securities registered in the Public Registry of the Stock Market that are carried out through centralized negotiation mechanisms or not, will no longer be exempted from the Income Tax.

Additionally, when the LD enters into force, the applicable rate to the capital gains obtained by the transfer of securities will be of 5% over the gross income, provided that the transfer is carried out in Peru. Nevertheless, if the transfer of securities is carried out outside of the country, the rate will be of 30% of the gross income.

It is also worth mentioning that the definitions for the terms transfer carried out inside of Peru and transfer carried out outside of Peru have not yet been provided. A proper set of regulations to these new dispositions is still pending.

Income Tax of Domiciled Legal Entities. Paragraph d) of article 27 of the ITL classify capital gains obtained by a domiciled legal entity as third category income.

Nevertheless, according to part 1 of paragraph l) of article 19 of the ITL, the capital gains obtained by domiciled legal entities resulting from the transfer of securities registered in the Public Registry of the Stock Market carried out

through centralized negotiation mechanisms are exempted from the Income Tax until the 31st of December of the present year.

Notwithstanding, the LD has abolished paragraph l) of article 19 of the ITL. Hence, since its enforcement on the 1st of January of 2009, the capital gains obtained by domiciled legal entities resulting from the transfer of securities registered in the Public Registry of the Stock Market that are carried out through centralized negotiation mechanisms, will no longer be exempted from the Income Tax.

Therefore, capital gains obtained by a domiciled legal entity as a consequence of the transfer of securities will be part of the taxable income of the above mentioned legal entities. The applicable rate will be of 30% over the entitys total net income.

Income Tax of Non Domiciled Legal Entities. According to part 1 of paragraph l) of article 19 of the ITL, the capital gains obtained by non domiciled legal entities resulting from the transfer of securities registered in the Public Registry of the Stock Market carried out through centralized negotiation mechanisms are exempted from the Income Tax until the 31st of December of 2008.

Notwithstanding, the LD has abolished paragraph l) of article 19 of the ITL. Hence, since its enforcement on the 1st of January of 2009, the capital gains obtained by non domiciled legal entities resulting from the transfer of securities registered in the Public Registry of the Stock Market that are carried out through centralized negotiation mechanisms, will no longer be exempted from the Income Tax.

Additionally, the applicable rate to the capital gains obtained by the transfer of securities will be of 5% over the gross income, provided that the transfer is carried out in Peru. Nevertheless, if the transfer of securities is carried out outside of the country, the rate will be of 30% of the gross income.

Again, as in the case of the non-domiciled individuals, the definitions for the terms transfer carried out inside of Peru and transfer carried out outside of Peru have not yet been provided. A proper set of regulations to these new dispositions is still pending.

Attribution of Income Obtained from Investment in Funds and Trusts. Currently, according to article 29-A of the ITL, the profits, income, capital gains obtained from Mutual Funds of Investment in Securities, Investment Funds, Trust Net Worth Securitization Entities, including the ones resulting from the redemption or rescue of securities issued in the name of the abovementioned funds or trusts and from Banking Trusts, will be attributed at the end of the fiscal year, to the corresponding participants, beneficiaries and settlers, after deducting the expenses and losses.

Nevertheless, the LD has modified this. Since its enforcement, the expenses and losses generated will only be deductible if the income to which they are related constitutes third category income (business income).

Withholding Agents. According to the current paragraph d) of the article 71 of the ITL, the legal entities that pay or credit income from bearer obligations or other securities qualify as withholding agents. Nevertheless, the LD has modified this, adding that the Compensation and Liquidation Chambers (i.e. CAVALI) or those who exercise similar functions in case of operations with instruments or securities carried out in centralized mechanisms of negotiation (i.e. the Lima Stock Market) also qualify as withholding agents. This generates a problem for the Compensation and Liquidation Chambers since currently there are no mechanisms in place that could let them act as withholding agents, a function that could result in an extra cost for investors. Additionally, there are still no regulations for this new disposition that explains how the Compensation and Liquidation Chambers will act as withholding agents.

Likewise, paragraph e) of article 71 of the ITL when modified by the LD will indicate that Mutual Funds of Investment in Securities, Investment Funds, Trust Net Worth Securitization Entities and Banking Trusts Trustees will have to act as withholding agents regarding profits, income or other capital gains that are paid or are generated in favor of the holders of the securities issued on behalf of these funds or net worths, or of the trustor of the banking trust,

provided that these have not been subject to a previous withholding at the source. Again, the regulations are still pending.

Return to Text

n1 Nowadays, according to the article 36, in order to determine the second category net income, a 10% deduction is allowed from the gross income. Once the second category net income is established, it would be added to the other income generated by the individual (Including the foreign source income, in case there is a positive result after their compensation). The following accumulative progressive scale will be applied to determine the corresponding tax:

Scale: Rate:

Up to 27UIT (1 UIT= S/.3,500) 15%

More than 27UIT and up to 54UIT 21%

More than 54UIT 30%

ABOUT THE AUTHOR(S):
Gustavo Lazo Saponara is a Partner in Estudio Olaechea (http://www.esola.com.pe) and head of the Tax Department. He is a Lawyer and an Accountant by the Pontificia Universidad Catlica del Per. **Giorgio L. Massari Figari** is an Associate in Estudio Olaechea and a member of the Tax Department. He is a Lawyer by the Pontificia Universidad Catlica del Per.

Information referenced herein is provided for educational purposes only. For legal advice applicable to the facts of your particular situation, you should obtain the services of a qualified attorney licensed to practice law in your state.

3 of 3 DOCUMENTS

Emerging Issues Copyright 2009, Matthew Bender & Company, Inc., a member of the
LexisNexis Group. All Rights Reserved.

Otto on Changing Chinese Accounting Standards

2008 Emerging Issues 2606

Otto on Changing Chinese Accounting Standards

By Jens Peter Otto

July 29, 2008

SUMMARY: China is developing a modernized legal framework at a remarkable speed. The new Chinese Accounting Standards have to be applied for financial years starting January 1, 2007. This expert commentary, written by international tax advisor Jens Peter Otto, analyzes recent developments in Chinese accounting standards and provides advice for readers of financial statements and preparers of annual accounts.

PDF LINK: Click Here for Enhanced PDF of Commentary

ARTICLE: Cite as: Otto, Jens Peter. Changing Chinese Accounting Standards. LexisNexis Expert Commentary, *(Insert date you accessed the document online).*

I. Introduction. China is developing a modernized legal framework at a remarkable speed. The tax reform enacted by the National Peoples Congress in March 2007 and the recently introduced changes to the Partnership Law and the Bankruptcy Law are only a few examples of the huge efforts China is currently undertaking to provide its soaring economy with a modern, transparent, and reliable legal basis.

The implementation of the new accounting standards has to be viewed from the same angle. Chinas stock market, already of considerable size in terms of market capitalization, but for foreigners still only accessible to a limited extent, is increasingly attracting international capital. To satisfy the need of globally operating investors and analysts for providing reliable financial data as a sound basis for their investment decisions, the new Chinese Accounting Standards have to be applied for financial years starting January 1, 2007. However, for the time being, this only applies to listed companies.

The development of modernized accounting principles has been pursued since 1993 with the help of the World Bank. Furthermore, China committed itself to aligning its domestic accounting principle to IFRS in the long term. n1

This article provides advice on some aspects of changing Chinese accounting standards for the reader of financial statements as well as for the preparer of annual accounts.

II. Who Should Apply the New Rules and When. For the time being, only listed entities have to apply the new rules starting with the financial year 2007. This is at least true for entities that have offered shares. Whether the new

requirements also extend to companies issuing corporate bonds is not explicitly addressed, but guidance is expected to come out within this year. As there is no possibility to have a financial year diverging from the calendar year in China yet, the application of CAS 2006 will start on January 1, 2007. Non-listed companies are not yet affected by CAS 2006; this therefore also applies to FIEs n2. Those companies still have to prepare financial statements in accordance with the previous standards and supplemental regulations. The application of CAS 2006 by non-listed companies is, however, allowed and expressively encouraged by the MOF n3. The State-owned Assets Supervision and Administration Commission of the State Council (SASAC) ruled in its pronouncement 2006/194 that all significant state owned enterprises have to apply CAS 2006 from business year 2008 on. It can be assumed that the mandatory application of the new standards by other entities will also be on the agenda of the MOFs deliberations in the future. It might therefore be worthwhile to start thinking about the probable impact of the implementation of CAS 2006 on your company.

III. Relevance of Chinese Financial Statements for Investors Decisions After 2007. CAS 2006 is in itself a big step towards convergence with IFRS and improves the international comparability of financial statements. Still, caution is recommended when reading financial statements of Chinese companies. In order to be relevant for forming the basis of decisions made by investors, financial statements need to be reliable in terms of achieving high quality and adherence to relevant existing regulations. Therefore, closing the gap between IFRS and Chinese accounting principles is not the only obstacle to overcome when attempting to enhance the usefulness of financial statements for international investors. There may be other factors attributable to the Chinese business environment that might have a negative impact on the quality of financial statements.

Preparing financial data for the purpose of satisfying the needs of an indefinite number of stakeholders (e.g. investors, lenders, tax authorities, employees etc.) has not yet had a long tradition in China. Traditionally, financial statements in the state-directed economy in China served the purpose of forming the basis for calculating the correct amount of taxes and government supervision, rather than providing free financial markets with relevant information for making investment decisions. Accordingly, the tax regulations still seem to have a material impact in the day to day accounting practice. At least in the practice of smaller businesses, it is not uncommon that sales and expenses are not allocated to the period when risks and rewards in connection with a business transaction have been transferred but when the official tax receipts (fapiao) for the underlying transaction have been issued / received. This is because VAT input tax may, under current VAT regulations, only be claimed when the tax payer has received the tax receipt. However, under previous GAAP as well as under CAS 2006, sales and expense recognition should follow the accruals principle.

The enforcement of laws enacted by the central government in China may vary from province to province. Companies sometimes do not fulfill their contractual or public obligations, especially in cases where the counterparty is in a weak position, for example, the employees. Payment of contributions to social security funds (i.e. pension, medical care, housing, unemployment) is sometimes neglected without recording a respective liability. The one who suffers in this case is the employee, as he will, in the occurrence of the event insured, not receive any payments. The risk of legal prosecution of such a breach of law seems to be, at least in the perception of the companys management, at an acceptably low level, as such practice, which is unacceptable even under Chinese corporate governance principles, is still pursued. With the progressing reform of the Chinese legal system, the risk of discovery of and being prosecuted for such violation of law will increase. Transparency of the financial position can only be achieved if liabilities are recorded completely in the companys financial statements.

As CAS 2006 has only been introduced recently, people need time to digest the new rules. Especially complex accounting issues such as sale-and-lease-back, upfront payments, bill-and-hold-arrangements, commission schemes, or transactions among related parties need, now more than ever, careful consideration. The demands on the accounting personnel, the information technology, and the related internal controls which come along with the new accounting rules have increased significantly. These demands can only be met by a highly skilled and sufficiently trained workforce. For this reason the MOFs target has been to enhance professional accounting qualifications in China n4. The labour market for highly skilled accountants, however, has in recent years been very tight, and this will continue for the next couple of years.

IV. Project Work: Implementation of CAS 2006 into an Existing Organization. Implementing a new set of accounting rules in your companys organization may prove to be more complex than it looks at first glance. Everyone who has gone through the process of changing over to IFRS from a countrys local accounting principles, for example in Europe, n5 knows that it can be a quite demanding task. Those who think that only a few numbers have to be crunched in a slightly different way misjudge the time and human resources to be involved in such an implementation exercise. For the various disclosure requirements in the notes to the financial statements that have been expanded compared to current China GAAP, one has to ensure that the required information is available and accessible promptly for the accounting department. In this context, it is also recommended to assign clearly which department is responsible for which data collection. One has to examine whether the bookkeeping system currently in use is able to process the necessary data under the requirements of CAS 2006. If need be, the existing accounting system has to be upgraded or even replaced by more powerful integrated software. Before the actual application of CAS 2006, it is also highly recommended to study the extent of the impact of the modified accounting principles on the various key performance indicators (e.g. equity ratio, EBIT, ROI etc.) and to inform the recipient of the financial information early to avoid any late surprises.

In light of all of these considerations, it is advisable to start a project well in advance of the envisaged first time application of CAS 2006 with the objectives, firstly, of studying the necessary changes to processes within the organisation and, secondly, of implementing these changes. Not every company will likely be affected in the same way. For example, leasing companies may have to embark on a totally different change over process (because of the new requirements in Standard No 21: Leases) than manufacturers. Furthermore, it has to be observed that not only the current financial data has to be in line with the new accounting principles but also at least partially the comparative figures. CAS 38: First time adoption of accounting standards requires in certain cases adjusting the comparative prior years figures to the new CAS 2006 principles.

31.12.20x2

1.1.20x1

31.12.20x1

Beginning balance / prior years comparatives in line with CAS 2006

Forecast data following CAS 2006

Financial statements in line with CAS 2006

Financial statements in line with CAS 2006

Budgeting process following CAS 2006

Begin to record transactions based on CAS 2006 in accounting system of operating companies

Conversion of the financial statements

Conversion to CAS 2006

At a minimum, the following subject matters should be included in the project:

. Identify the key issues and differences compared to previous accounting principles, estimate time and personnel resources to be involved;

. Identify the need for adjustments and additional disclosures in the notes and produce the opening balance sheet / prior years comparatives in accordance with CAS 2006;

. Amend or produce new accounting policies and manuals ;

. Consider how the reported business performance will change;

. Consider the implications of the change to CAS 2006 for corporate governance and structure of the organization including the impact on the budgeting process;

. Deliver the transfer of knowledge at both the executive and operational levels (e.g. training, new hires);

. Change reporting and business processes and procedures, as necessary to achieve the required new way of working;

. Identify current data gaps and system deficiencies (e.g. new set of account codes, new interfaces between systems, new report queries on system-derived data), with IT department playing a vital role in the process;

. Develop a detailed systems strategy to support new processes and procedures; and

. Implement a phased introduction of new systems to ensure that all staff are fully equipped for their new responsibilities and that the business can run smoothly at each stage.

Although not compellingly necessary, the change to CAS 2006 might be a welcomed occasion also to change an outdated accounting system to a new and integrated ERP-system, as such new software could form the underlying basis to strengthen the companys internal control system and to generate more reliable financial data.

V. Conclusion. With the introduction of CAS 2006, China has made a big step towards IFRS. Currently, only stock listed companies have to comply with these new accounting principles on a mandatory basis. However the Ministry explicitly encourages other preparers of financial statements voluntarily to adopt the new accounting principles. If and when the range of mandatory applications are widened remains to be seen; it is recommended to stay informed and to prepare now for a conversion. Whether the new CAS 2006 will actually improve the quality of financial statements of Chinese enterprises from 2007 on as intended depends not least on whether the set of rules and regulations will be correctly applied immediately.

Return to Text

n1 . Feng Shuping: Strengthen the co-operation to promote international convergence of accounting standards, speech at the IASB Meeting on 18 November 2002 in Hong Kong; also: China affirms commitment to converge with IFRS, IASB News from 15 February 2006, www.iasb.org/news.

n2

[2]. FIE: Foreign Invested Entities, including WFOE: Wholly Foreign Owned Entity, i.e. a subsidiary of a multinational group incorporated in China.

n3

[3]. Notice issued by the MOF 30 October 2006.

n4

[4]. Speech by Jun Wang, Vice Minister of MOF at the 17th World Congress of Accountants on 14 November 2006 in Istanbul / Turkey, see http://www.cicpa.org.cn/English/smallclass

n5

[5]. In Europe all public interest entities have to prepare their financial statements in accordance with IFRS starting with the financial year beginning on or after 1 January 2005, see EU-directive 1606 / 2002

ABOUT THE AUTHOR(S):

Jens Peter Otto is a certified public accountant and licensed tax advisor registered in Germany. He started his professional career in 1991 in Hamburg with PricewaterhouseCoopers and has since been seconded to the offices in Tokyo (1998-2001) and Shanghai (since 2007). He serves multi-national clients with a focus on annual audits. His technical expertise comprises among others IFRS, US GAAP, German GAAP, Japanese GAAP and most recently China CAS.

Expert Commentary is the title of this LexisNexis publication. All information provided in this publication is provided for educational purposes only and use of the term Expert Commentary is not intended to describe or designate the authors qualifications as a lawyer or in a subspecialty of the law. For legal advice applicable to the facts of your particular situation, you should obtain the services of a qualified attorney licensed to practice law in your state.