

Guiding Opinions on the Regulation and Development of Small and Medium Practices

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To Institutes of Certified Public Accountants in provinces, autonomous regions, and municipalities directly under the Central Government (hereinafter referred to as local institutes):

In recent years, under the guidance of the Ministry of Finance, the Chinese accountancy profession has made great progress by:

- (1) Undertaking an in-depth analysis of the new requirements on the profession brought about by economic and social development;
- (2) Summarizing the development experience of the Chinese accountancy profession;
- (3) Undertaking an in-depth study of laws of development of the global accountancy profession;
- (4) Proposing and implementing strategies for talent cultivation, international convergence of standards and promotion of more competitive and bigger accounting firms.

We have formulated the Guiding Opinions on the Regulation and Development of Small and Medium Practices in order to:

- (1) Adapting to the requirement of accelerating the improvement of China's market economic system;
- (2) Comprehensively improving the ability of the Chinese accountancy profession to serve economic and social development;
- (3) Improving the services structure of the profession;
- (4) Enhancing the overall quality of the profession;
- (5) Promoting more competitive and bigger accounting firms.

I The necessity for regulating and developing small and medium Practices (hereinafter referred to as SMPs)

Along with the rapid development of China's market economy, the continuous expansion of

enterprises and the implementation of “going global” strategy, the Chinese accountancy profession needs a number of large accounting firms that are able to provide comprehensive services to large enterprises. In addition, SMPs also need to provide high-quality, specialized services to Chinese enterprises of diverse scale and demand.

Addressing the above issues, the Chinese accountancy profession should optimize its structure in terms of the diversity of firms’ size, regional distribution and services, so as to enhance the overall service ability of the profession. Therefore, the regulation and promotion of SMPs are both inherent parts of the strategy of promoting more competitive and bigger accounting firms and an essential requirement for promoting the development of the profession.

SMPs play an important role in creating employment opportunities, strengthening economic vitality and enhancing economic and social development. In recent years, China has actively promoted the development of small and medium enterprises from a strategic level - that of the economic structural adjustment and transformation of economic development models, with a focus of providing legal protection and policy support. Small and medium-sized enterprises have become an important part of national economy.

SMPs enjoy the advantages of low operating costs, professionalism and flexible services, which allow them to better serve small and medium enterprises, which are large in number and small in scale. As part of small and medium businesses, SMPs are the major service providers in serving small and medium enterprises, and are essential for China's economic and social development.

Regulating and promoting SMPs is also an pressing issue for accounting firms to survive and to develop. At present, China's SMPs face internal and external challenges in such aspects as the foundations of their development, market access, and practice environment. A considerable proportion of SMPs face problems such as lack of marketing capability, shortage of professional talent, non-standardized internal management and weak branding, all of which have hindered their survival and development.

In order to adapt to profound economic and social changes, SMPs must:

- (1) Standardizing management and operations;
- (2) Innovating development models, services and technical methods;
- (3) Tapping into market demand;
- (4) Enhancing the supply of professional services;
- (5) Changing the traditional concept of solely developing accounting services;
- (6) Vigorously expanding consulting services such as tax compliance and verification, tax consulting, management consulting and proxy advisory services;

(7) Expanding the scope of services;

(8) Improving service levels.

II The overall objectives of regulating and developing SMPs

The overall objectives of regulating and developing SMPs are to:

(1) Using market demand as guidance;

(2) Exploring and summarize the principles of development of SMPs;

(3) Expanding the business scope of accounting firms according to laws;

(4) Guiding accounting firms to innovate their institutions, management, technology and services;

(5) Strengthening the foundation of development of SMPs;

(6) Promoting the unique advantages and the important role of SMPs.

A group of SMPs should be developed with sound internal management, strict quality control, high-quality, specialized services and strong social credibility over the next five to ten years that are able to meet China's economic and social development.

III Strict management and strong supervision to enhance practice standardization of SMPs

Review the qualifications of partners (shareholders) and CPAs in SMPs

Local institutes should conduct substantive reviews of partners (shareholders) who apply to set up accounting firms to ensure that the applicant has good professional ethics and high professional competence. The review should include a comprehensive assessment of the applicant's period of practice, professional experience, quality of work, integrity and management experience.

Local institutes should strengthen annual inspections of the qualifications of CPAs in SMPs, with an emphasis on their practices, integrity and completion of continuing professional development. CPAs will fail the annual inspection under certain circumstances, such as working part-time at accounting firms, unable to conduct civil responsibilities, and refusing to fulfill membership obligations. Only through these measures will SMPs attain high quality CPA teams.

Local institutes should conduct research on classification assessment system on CPAs' competency, guide SMPs to build a management system for classified management of professionals, and guide the establishment of a scientific use of self-regulatory mechanism and quality control on the cultivation of talents

Strengthen the supervision and review of the practice quality of SMPs

- (1) Local institutes should accelerate the construction of a comprehensive information recording and real-time monitoring system for SMPs and their CPAs;
- (2) Local institutes should build an information disclosure system;
- (3) Local institutes should inspect the practice quality of accounting firms with a five-year cycle and strictly carry out the review and disciplinary measures to improve the practice quality of SMPs;
- (4) Local institutes should try to establish a classification system for supervising SMPs by types of accounting firms. They should shorten the review cycle and conduct special reviews for accounting firms with poor quality practice and a low standard of professional ethics;
- (5) Local institutes should establish a special review system. Verified acts of unfair competition in violation of professional ethics, such as taking kickbacks and committing fraud, should be subject to serious disciplinary penalties.

Study and explore the possibility of establishing credit rating system for SMPs

- (1) Credit rating should be assessed through objective examinations of

resources system designed to recruit, train and retain talents;

- (2) Investment in training should be increased and professionals should be sent to participate in professional training programs;
- (3) A sound social security system should be established for employees. Labor contracts with employees would be signed and relevant social insurance should be paid in line with laws;
- (4) A fair and reasonable income distribution system should be established, and concepts and mechanisms for sharing the fruits of development among all employees should be in place.

Vigorously develop specialty services to meet market demands

- (1) SMPs should identify their market positions and continuously strive to perform better and focus on the niche markets;
- (2) Guided by new market demand, SMPs should continuously develop services including capital verification, audit of financial statements, tax compliance and verification, tax consulting, valuation of assets and liabilities, bookkeeping and management consultation;
- (3) SMPs should continue to promote service innovation, and vigorously develop services including bankruptcy management, credit certificates, proxy company registration, customs declaration agents, market surveys, due diligence, social responsibility investigations, employee social security surveys, common technology transfers, human resource advisory, and rural financial disclosure;
- (4) SMPs should jointly develop professional services, professional brands and competitive advantages by establishing strategies for professional development, industrial chain development and integrated management.

Accelerate the development and promotion of auditing techniques

- (1) SMPs should grasp advanced auditing techniques, improve their audit abilities in IT-driven environments, and achieve synchronous development with customers' information technology;
- (2) SMPs should increase capital investment to equip themselves with audit tools under IT-driven environment and attract IT professionals to join accounting firms so as to improve the technological content and quality of services, and enhance the capabilities of providing value-added services.

Establish a sound and effective quality control system

- (1) Partners (shareholders) of SMPs should have direct leadership responsibilities for the quality of services;
- (2) SMPs should formulate policies on personnel performance evaluation, compensation and promotion that are driven by quality, responsibility and risk control, with the purpose of improving service quality and controlling business risks.

Establish organizational structure and internal governance mechanisms which adapt to the requirements of market competition

- (1) SMPs should be encouraged to explore professional corporate management and operations under the legal framework, and to achieve the integration of accounting services with other professional services;
- (2) SMPs should enter into a partnership agreement (constitution) to build an internal governance mechanism that complies with laws and regulations.

Cultivate and build brands that are known for excellence and specialty

- (1)

information platform of management, supervision and service, and establish an information service network to link relevant governments and organizations, industrial and trade associations and enterprises.

Strongly support SMPs in cultivating talents

- (1) Local institutes should develop a talent cultivation plan and improve the talent training system;
- (2) Local institutes should establish a special fund for talent training and increase investment in talent training;
- (3) Local institutes should explore the way of providing on-demand training for SMPs, and strengthen special training for partners (shareholders) and CPAs to enhance the relevance and usefulness of training;
- (4) Local institutes should continuously expand the international vision of partners (shareholders), as well as that of key individuals of the business, by actively carrying out international exchanges and organizing overseas study, research and training;
- (5) Local institutes should continuously provide assistance in personnel training for SMPs in western regions and minority group-inhabited areas.

Provide guidance to accounting firms in exploring domestic and international markets and emerging businesses

- (1) Local institutes should strengthen coordination with relevant parties to encourage SMPs to actively participate in bidding for government procurement projects and other professional projects;
- (2) Local institutes should create a well-known platform for the promotion of SMPs, organize various activities, such as trade fairs, conferences, brand promotion and overseas business trips;
- (3) Local institutes should guide accounting firms to undertake outsourcing services in accounting, encourage accounting firms to support the “going global” activities of small and medium enterprises and to expand the international market.

Increase efforts to provide technical services to SMPs

- (1) Local institutes should formulate guidelines for audits of small and medium enterprises;

- (2) Local institutes should develop auditing software for SMPs and promote the modernization of auditing techniques;
- (3) Local institutes should create an expert advisory team to provide technical consulting services for SMPs;
- (4) Local institutes should encourage the construction of IT systems and promote the application of information technology in SMPs.

Promote the development and application of best management practices of SMPs

- (1) Local institutes should utilize domestic and foreign experience to develop best practice guidelines to regulate SMPs;
- (2) Local institutes should actively guide SMPs to merge and consolidate, so as to build institutional scale and capabilities in line with market and development needs.

Actively improve the policy and market environment for the development of SMPs

- (1) Local institutes should strengthen ties and communication with relevant government departments, and strive to gain the support from the Small and Medium Enterprises Development Fund to help with accounting firms' technological innovation, personnel training and international market expansion;
- (2) Local institutes should actively communicate and coordinate with government departments and agencies, such as industrial & commercial bureau, taxation bureau, pricing authorities, financial regulators, audit authorities and justice organizations, so as to build collaboration mechanisms to promote the development of SMPs;
- (3) Local institutes should research standards and calculation of service charges and promote the introduction of guiding opinions on charges for services.

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