

# Guidelines on Internal Governance of Accounting Firms

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## Chapter I General Provisions

These guidelines are formulated pursuant to *the Company Law of PRC, Law of PRC on Partnerships*, the *Law of PRC on CPAs* and relevant laws and regulations to strengthen the internal governance of accounting firms (hereinafter referred to as “the firms”), to develop and improve internal decision-making and management mechanisms, to enhance risk management and quality control capabilities of the firms, and to lay a solid foundation at the micro-level for the firms to grow bigger and stronger.

These guidelines aim to provide guidance for the firms to strengthen their capacity in the development of articles of association (or partnership agreements in case of firms operating in partnership, hereinafter referred to as the “articles of association”) and institutional systems as well as to improve their internal governance and internal management.

The articles of these guidelines shall be applicable to all limited liability firms and firms and partnership firms, unless otherwise specified.

The internal governance of the firms shall serve the purpose of protecting public interest, through the establishment of a governance structure and mechanism with stringent risk management, effective quality control, transparency and mutual checks and balances.

The internal governance of the firms shall be based on laws and regulations, for establishing a comprehensive internal decision-making and management system that is hinged upon the articles of association and fostering for a management environment that is respectful and abiding to the system.

Promotion of “combination of people” shall form the foundation of the internal governance of the firms. The intellectual labor and professionalism of Certified Public Accountants (CPAs) shall be respected, and expertise and knowledge shall play a leading role in the firms' internal decision-making and management.

The internal governance of the firms shall focus on internal harmony, with reasonable standards and effective coordination among the firms’ shareholders (partners), among their shareholders (partners) , CPAs and employees, and among other related parties, maximizing the functions of their management bodies at all

levels to safeguard the legitimate rights and interests of the firms and their stakeholders.

The internal governance of the firms shall be driven by a partnership culture, which actively establishes the governance philosophy of "combination of people and affairs for joint efforts through unified hands and minds" to promote a partnership culture of integrity, cooperation, equality and consultation across the firms.

## **Chapter II Shareholders (Partners)**

### **Section I Rights and Obligations of Shareholders (Partners)**

The firms shall stipulate the rights and obligations of their shareholders (partners in case of partnership, hereinafter jointly referred to as the "shareholders") in their articles of association.

All shareholders of the firms shall have equal status. They shall have confidence in each other to establish a harmonious relation among themselves with mutual respect, communication and consultation in the pursuit of common development.

Shareholders shall have the right to exercise voting rights at the shareholders'

of the firms or other shareholders.

A shareholder shall not engage in any business competing or conflicting with the interests of the firms, and shall not use any business information or trade secrets obtained from his or her identity and capacity as a shareholder to seek any business opportunity belonging to the firm and to damage the interests of the firms as a whole.

The major shareholder shall not use his or her special capacity to damage the legitimate rights and interests of the firms or other shareholders.

A shareholder shall be liable to make compensation for any damages he or she causes to the firms in violation of the relevant laws and regulations, industry standards or the articles of association of the firms.

The firms shall establish a dispute resolution mechanism to resolve shareholder disputes. Where a dispute cannot be resolved through negotiation, the firms may apply for arbitration, or file lawsuits with a people's court.

## **Section II Admission and Withdrawal of Shareholders**

All shareholders shall, in addition to the qualifications stipulated by laws and regulations and the industry standards, meet the requirements of the firms in terms of integrity, professional experience, proven ability, age and other aspects stipulated in the articles of association.

The firms shall stipulate the procedures for the admission of new shareholder in their articles of association, and specify the rights and obligations of the existing and new shareholders. Where the articles of association do not stipulate the rights and obligations, both the new and existing shareholders shall enjoy the same rights and bear the same obligations.

The admission of new shareholder is subject to the approval of shareholders' meeting and an admission agreement must be concluded in writing.

Upon such entry, the existing shareholders shall truthfully perform the obligation of informing the new shareholder.

The firms shall, in their articles of association, stipulate the circumstances and procedures for the withdrawal of shareholders. Where a shareholder complies with the withdrawal requirements, the withdrawal shall be approved pursuant to the agreed procedures.

The firms shall, in their articles of association, stipulate the circumstances for compulsory withdrawal, including but not limited to quitting full-time practice at the firm, resigning from the firm, exceeding of agreed age limit, and losing shareholder qualifications.

Article XVIII The firms shall, in their articles of association, stipulate the measures for the settlement and return of the part of property which is related to the withdrawal of shareholders.

Where any of the firms' debts are incurred by the shareholders prior to their withdrawal, the firms shall clarify the liability to be borne by the shareholder.

The firms shall, in their articles of association, stipulate that the shareholder qualification shall not be inherited. For any legal heir to the shareholder's property intending to become a shareholder of the firm, he or she shall meet all the qualifications of the firms' shareholders, and shall follow the procedures for the admission of new shareholder as stipulated in the firms' articles of association.

Where the legal heir fails to fulfill the qualifications of the firms' shareholders, the firm shall return to him or her the property shares of the inherited shareholder.

### **Section III Capital Contribution of Shareholder and Transfer of Equities (Share of Property)**

The firms shall, in their articles of association, stipulate the form of shareholder capital contribution, contribution amount, contribution proportion, timing of such contribution, and the corresponding liabilities for breach of contract.

The shareholders shall meet the obligation of capital contribution according to law, make their respective capital contribution in accordance with the agreed amount of contribution amount based on the schedule stipulated in the articles of association, and shall not make any false capital contribution, or illegal or surreptitiously withdraw the contributed capital, or occupy or transfer any property of the firms in any manner.

A shareholder shall directly hold the equities of the firms, and shall neither hold any equities for any other person nor entrust any other person to hold any equities for him or her.

The firms shall, in their articles of association, stipulate the procedures and measures for transferring all or part of the equities among shareholders or to a person other than a shareholder.

The other shareholders shall have a pre-emptive right to acquire all or part of such equities in the transfer.

When a shareholder proposes to transfers all or part of their equity interests to a person other than a shareholder, the transferee shall meet the requirements and qualifications of the shareholders as stipulated in their articles of association.

The equity transfer procedures shall be properly completed for any transfer of all or part of a shareholder's equities of the firms among shareholders or to a person other than a shareholder according to law.

The firms shall, in their articles of association, stipulate that a shareholder shall not pledge any of his equities of the firms.

## **Chapter III Decision-making and Supervision**

### **Section I Shareholders' (Partners') Meeting**

The shareholders' meeting (or partners' meeting in case of partnership, hereinafter jointly referred to as the “shareholders' meeting”) is the supreme authority of the firms. The firms shall ensure the normal operation and authority execution of the shareholders' meeting, no shareholder shall override the shareholders' meeting, or bypass it or act on its behalf beyond the authority properly authorized by the shareholders' meeting.

The firms shall establish a reasonable ownership structure according to their own scale. Large and medium-sized firms shall reasonably disperse the ownership of equities to prevent the monopoly of control by an absolute controlling shareholder.

The operation of the shareholders' meeting shall comply with the provisions of the laws and regulations, industry standards and the articles of association of the firms.

The firms shall, in their articles of association, stipulate the terms of reference, the methods of proceedings and the voting procedures of the shareholders' meeting, and establish detailed rules of proceedings on the convening of the shareholders' meeting, the deliberation of proposals, the procedure of voting, the recording and signing of the meeting minutes, and the announcement and effect of the resolution, so as to fully ensure that the shareholders' meeting shall perform its duty and operate effectively as agreed.

The shareholders' meeting shall have the right to authorize the board of directors (partner management committee) to exercise some of its powers and duties, while

the authority shall be clear and specific, and be stipulated in the firms' articles of association or approved by the shareholders' meeting.

The shareholders' meeting shall be cautious in any authorization that may cause a significant impact on the firms.

The shareholders' meeting shall ensure that each shareholder has the right to sufficiently participate in proceedings, discussions and decisions-making, and shall respect the shareholders' proposals and allocate time needed for discussing each proposal.

Based on the philosophy "combination of people" in the profession, the firms shall, in their article of association, stipulate the distribution of voting rights at their shareholders' meeting.

Firms in partnership shall adopt one vote per person approach or other methods featuring "combination of people" in the distribution of voting rights.

Limited liability firms shall adopt one vote per person approach, or voting rights based on capital contribution and the number of shareholders or other methods featuring "combination of people" in the distribution of voting rights if their ownership structure fails to reflect professional opinions in decision-making.

Based on the importance of the matters to be voted, the firms shall have the right to, in their articles of association, stipulate different voting procedures at their shareholders' meeting.

General matters shall be passed by shareholders holding more than half voting rights in a shareholders' meeting.

Matters related to material interests of the firms, such as amendment to the articles of association of the firms, firm merger, division, dissolution or change of firm structure, increase or reduction of registered capital, open or cancellation of branches, shareholders admission and withdrawal etc., shall be passed by shareholders holding two-thirds or more of the voting rights in a shareholders' meeting.

## **Section II Board of Directors (Partner Management Committee)**

The firms shall establish a board of directors (partnership management committee in case of partnership, hereinafter jointly referred to as the "board of directors"), which is elected by the shareholders at the shareholders' meeting and accountable to report its work to the shareholders' meeting.

A relatively smaller scale firm may appoint an executive director or executive partner instead of establishing a board of directors.

The operation of the board of directors shall comply with the provisions of the laws and regulations, industry standards and the articles of association of the firm.

The firms shall, in their articles of association, stipulate the qualifications and election procedures for the selection of their directors (or member of the partnership management committee in case of partnership, hereinafter jointly referred to as the “directors”), the number of directors, the composition of the board of directors, the terms of reference and the rules of proceedings of the board of directors, so as to ensure the efficient operation and scientific decision-making of the board of directors.

Directors elected by the firms shall have good professional ethics and a track record of integrity, and possess the required professional, management, coordination and board proceeding ability, as well as extensive work experience to perform his or her duties faithfully and diligently.

The board of directors and its members shall treat all shareholders equally, and shall pay attention to the rights and interests of other stakeholders.

The board of directors shall ensure adequate time and perform complete procedures when relevant matters are deliberated. A one vote per person voting approach shall be adopted.

Directors shall attend board meetings in person. Where a director is unable to attend a meeting, he or she can issue a power of attorney to appoint another director to attend the meeting on his or her behalf. The power of attorney shall state the scope of authorization, as well as specify his or her opinion towards the matters to be voted upon.

The firms shall have the right to, in their articles of association, limit the number of proxy voting and abstentions for a director to guarantee the efficiency of proceedings and the quality of resolutions at the board meetings.

The board of directors shall have the right to set up a development strategy committee, risk management and quality control committee, professional and technical committee, remuneration and appraisal committee and other specialized committees and develop clear working rules and term of references, so as to provide decision-making reference for the board of directors and ensure the functions of the board to come into full play.

Firms of relatively smaller scale shall specify the segregation of duties among the

directors instead of establishing specialized committees.

### **Section III Board of supervisors**

A limited liability firm shall set up a board of supervisors. Firms of relatively smaller scale may appoint one to two supervisors instead of establishing a board of supervisors.

The firms shall, in their articles of association, stipulate the qualifications of the supervisors, and the composition, duties and working rules of the board of supervisors, so as to ensure the duties of the board of supervisors are properly discharged.

The board of supervisors shall include shareholders' representatives and an appropriate proportion of employees' representatives to ensure that the board of supervisors exercises the right of supervision independently and effectively. The employees' representatives sitting on the board of supervisors shall be elected by the firms' employees.

A supervisor of the firms shall possess the professional knowledge, supervisory ability and work experience corresponding to his duties, and shall perform his duties prudently and diligently.

Directors and senior management personnel of the firms shall not hold the position of supervisor concurrently.

The supervisors shall supervise the financial activities of the firms and the performance of duties by directors and senior management personnel, as well as safeguard the legitimate rights and interests of the firms and their stakeholders.

The board of supervisors shall focus on matters relating to the rights and interests of minority shareholders, employees and other stakeholders.

The firms shall take measures to protect supervisors' right to information and provide necessary job security for the board of supervisors. Neither the board of directors nor any other person shall interfere or obstruct the board of supervisors in exercising its duties and authorities.

A supervisor shall have the right to know the operation of the firms and the relevant major decisions, and shall assume the corresponding confidentiality obligation.

### **Chapter IV Chief Accountant**



The firms shall appoint a chief accountant.

The role of chief accountant in a partnership firm shall be assumed by the executive partner in charge of the firms' practice.

The role of chief accountant in a limited liability firm shall be assumed by the legal representative selected from the directors.

the characteristics of their customers, with an appropriately arranged talent structure in terms of professional knowledge, skills, experience and age.

In employee recruitment, the firms shall focus on the professional integrity and professional development potential of the candidates, and shall sign a labor contract with each candidate which they have decided to employ, specifying the employee's wage and benefits, social insurance, labor protection, and the conditions and procedures for the dismissal and resignation.

The firms shall sufficiently solicit the opinions and suggestions of their employees in considering and decision making regarding major issues involving material interests of their employees such as wage and benefits, labor protection, social insurance, etc.

The firms shall give full attention to professional ethics education, maintenance of professional competency and career development of their employees by establishing and improving their staff training programs consisting mainly of pre-engagement training, continuing education and career development.

The firms shall make reasonable arrangement on the time, method and content of training, guarantee the quality of staff training, and provide support and conditions for their employees to complete the continuing professional education required by the profession. A newly employed staff shall receive pre-job training before work begins.

In addition to the overall planning of talent training structure, the firms shall also focus on their development strategy needs and pay particular attention to the cultivation of high-level professionals and management staff, so as to lay a solid foundation for sustainable development of the firm.

The firms shall establish a quality-oriented, scientific and appropriate system for employee performance evaluation, with both incentives and penalties, clearly establish the criteria, procedures and requirements for performance evaluation to fully mobilize the enthusiasm and creativity of all their employees.

The criteria for employee performance evaluation shall be objective, fair and comprehensive, and cover the professional practice quality, work intensity, work efficiency, work attitude, professional ethics, professional competence, market development ability, training completion status, amongst others, of an employee under evaluation.

The firms shall link the remuneration and promotion opportunities with the employee performance evaluation system, which ensure both a combination of professional skills and a combination of people, match accountability with remuneration while combine material reward with spiritual encouragement to constantly maintain and attract talents, to support the growth and development of

staff , so as to establish a mechanism for promotion of talents in line with their development strategy, market expansion and quality controls.

Professional quality is the lifeblood of the firms and the professional basis and integrity obligations of the profession to protect public interest. The firms shall, in accordance with the requirements of the quality control standards, formulate and implement scientific and rigorous quality control policies and procedures, and strengthen risk management to ensure effective quality control.

The firms shall specify the leadership responsibility and implementation body for engagement quality control, the control systems and professional ethics, the areas and sectors of risks and the control measures and procedures.

The firms shall strengthen the responsibilities of the board of directors in the establishment and implementation of quality control policies and procedures, and shall establish a system for the board of directors to deliberate and make decisions on major projects, high risk engagements and material issues, etc.

The chief accountant shall assume ultimate responsibility for the establishment and improvement of quality control policies and procedures and engagement quality control of the firm.

The firms shall establish a risk management and quality control committee or set up a dedicated body to monitor and control the engagement quality of the firm.

Firms of relatively smaller scale can appoint designated personnel to monitor and control their engagement quality.

The firms shall formulate a professional fee charging standards that can reasonably guarantee their practice quality, and shall not offer lower prices, pay commissions or rebates to others, share revenue or perform other form of activates to reduce charges which may impair the quality of professional practice.

The firms shall establish an engagement risk evaluation system. A risk evaluation should be performed before engagement acceptance and maintenance.

Where the firms has determined to accept an engagement, customer information shall be managed centrally to fully provide the basic information for the firms' unified engagement quality control, preventing customer information being monopolized by an individual or a department of the firms. Customer information shall include the customer's basic information, and the process and the results of the engagement.

The firms shall establish a classification management system for engagement quality control, clearly specify the criteria for the classification and identification of

routine and non-routine engagements, engagements with general risks and material risks and the involvement of public interests, and develop corresponding procedures for engagement quality control properly established.

The firms shall develop more stringent quality control procedures for non-routine engagements, high risk engagements or engagements which involve public interests.

The firms shall establish a practice avoidance system, and clearly specify the circumstances which may impair their independence in the course of practice that it should avoid and the remedies.

The firms shall ensure their independence in form and substance, formulate general requirements on the independence of the firms and the CPAs, regulations and standards on the evaluation and maintenance of professional independence, and specify the major factors affecting the independence of the firm and the CPAs and the measures to be taken in response.

The firms shall establish a system for reporting material risk matters. Professionals at all levels shall report material risk matters identified during the course of practice immediately to the designated body or personnel and senior supervisor.

The firms shall establish a professional consultation system to consult internal or external experts on major concerns or disputes.

The firms shall establish an engagement quality control review system, and identify the service types, reviewing methods and reviewing contents in the implementation of such reviews.

The firms shall establish a report issuance system, and regulate the report issuers and issuance procedures for all kinds of engagement reports and prohibiting the misconduct of offering any official seals.

The firms shall establish a system for the archiving, managing and use of their working papers.

The firms shall review and improve their quality control system on an ongoing basis, and shall establish a system of engagement quality inspection and evaluation and an accountability and compensation mechanism for engagement quality accordingly.

The firms shall withdraw and use the occupational risk fund in accordance with the provisions of the *Measures for the Management of the Occupational Risk Funds of Accounting Firms*. The firms can improve their occupational liability risk resistance ability through the purchase of occupational insurance, so as to provide an

accountability-based guarantee on public interest.

The firms shall not distribute their occupational risk fund during the period of their  
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The firms shall establish an engagement authorization checking system, and focus on regular or irregular checks over the engagements independently undertaken by their branches.

The firms shall appoint persons-in-charge of their branches in a unified manner, who shall control the operation and service quality of the respective branches. The persons-in-charge shall be the firms' shareholders.

The firms shall establish a system for their branches to report material issues. A branch shall, in a timely manner, report to the firms on the material issues arising over the course of practice, engagement acceptance status and results, the risk issues and other material uncertainties identified during professional practice.

The firms shall emphasize and strengthen the unified training for employees serving at their branches to ensure full and correct understanding and implementation of their practice standards, engagement quality control policies and procedures.

## Chapter VIII Development of Partnership Culture

Partnership culture is the inherent power to ensure the harmonious and sustained development of the firms. The firms shall carry on the essence of traditional cultures and draw on the achievements of modern management, so as to construct a partnership culture in line with the characteristics of the CPA profession and conducive to the sound development of the firm itself.

The partnership culture refers to the unified profession positioning, value proposition, development philosophy, moral standards and code of conducts nurtured throughout the history of the firms. The firms shall vigorously promote self-

communication mechanism of the governance body, and shall create a democratic atmosphere in the decision-making and implementation process, which will help promote understanding, create mutual tolerance, dissolve contradictions and enhance joint efforts.

The firms shall establish a mechanism for equal dialogues with their employees to smooth staff participation in their management, supervision and development, which will lead to a good custom of respect for knowledge, talent and the professional value of CPAs, adding to the sense of ownership of the employees.

The formation of a partnership culture comes from the full recognition and positive practice from all the employees. The firms shall launch various forms of cultural activities, such as image design and promotion, publicity and training, so as to foster a teamwork spirit among the employees and enhance the cohesion of the firm; they shall also establish a culture of integrity, develop positive, healthy and progressive behavior norms and working atmosphere, internalize the professional philosophy of integrity and professional ethics, and consolidate a professional image that is independent, objective and fair.

## **Chapter IX Information Communication and Disclosure**

Information communication and disclosure is an important way to supervise and regulate the corporate governance of the firms, channel the connections with the public and gain public trust. The firms shall establish a system of information communication and disclosure, including but not limited to the accounting and governance information, to effectively communicate and disclose the relevant information to all stakeholders.

The firms shall respect the right to information and the right to participate of the shareholders in their material events, and shall disclose in a timely manner to the shareholders the financial position and operation management of the firms, the important meeting resolutions and important systems, the remuneration policies for board members, the decision-making procedures for material events, the foreseeable major risks, the results of external supervision and inspection, and any other information that may have a substantial impact on the shareholders.

The firms shall establish a financial accounting report system to prepare financial accounting reports at the end of each fiscal year, and shall be subject to independent audit in accordance with the law.

The firms shall disclose information of their internal management system to the employees, including but not limited to the code of conduct, the performance evaluation system, the remuneration system, the promotion system, the training

system, the quality control policies and procedures.

The firms shall inform the employees of any major decisions affecting their future development.

Information disclosure shall help to promote public awareness of and confidence in the moral standards and practices of the firms. The firms are encouraged to establish an information disclosure system to disclose to the public their internal governance, the basic information of their shareholders and CPAs, their fee charging standards, the development of their risk management and quality control systems, the material rule-breaking violations and penalties, and other relevant information, so as to be subject to public supervision to improve their credibility.

The firms shall regulate the quality, scope, process and authority of their information disclosure.

The firms shall not involve any trade secrets or damage any interests of their counterparts or clients in information disclosure.

## **Chapter X Supplementary Provisions**

The Chinese Institute of Certified Public Accountants (CICPA) shall have the right to organize inspection and evaluation of the internal governance of firms.

These guidelines shall be subject to the interpretation of the CICPA.

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| Article | These guidelines shall come into force on January 1, 2008. |
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