SMALL COMPANY REPORTING

A FOCUS ON CHINA WITH UK COMPARISONS

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PROLOGUE: A TALE OF TWO COUNTRIES

(CONTRIBUTED BY CHRISTOPHER NOBES)

This report makes a number of international comparisons, but it focuses on two countries: China and the UK. This is partly because the report's author is Chinese and the report's sponsor is British. However, there are other reasons why the contrast of countries is interesting and might be instructive in both of them. As explained in this introductory note, the two countries are very different in important ways which affect accounting. If, despite these differences, we can come to similar conclusions for both countries on an issue, the conclusions are stronger and likely to apply more generally.

A little history and high-level comparison might be useful. China's civilisation and culture are thousands of years old; but let us start in the early modern period. In the sixteenth century, China's economy was the largest in the world. Beijing was the world's biggest city.[1] By contrast, England occupied one part of some small islands off the edge of Europe. It was under constant threat of invasion by more powerful countries to the south (France and Spain) and from the north (Scotland). However, by the middle of the nineteenth century, London had become the largest city in the world.[2] Britain had the world's biggest economy and controlled the greatest empire the world had ever seen. How had this astonishing transformation been achieved? The answer is commerce, backed up by suitable laws and good accounting. The expansion of the empire was led by merchant adventurers (in the first American colonies, then in India, and then in southern Africa) and by the navy which protected commerce and was paid for by the taxes on commerce. Britain has the world's second oldest stock market (after Amsterdam), it had the original industrial revolution, it built the first railways, and it was the first country to have widespread ownership of shares by non-managers of companies. These factors led to (and were then encouraged by) Britain being the first to require published financial statements (Companies Act 1844), having the world's first private-sector accountancy bodies (from 1853 in Edinburgh and 1870 in London), pioneering (with the USA) the setting of accounting rules by accountancy bodies rather than by the state, and being the natural base for the international standard-setters (the International Accounting Standards Committee from 1973 and then the International Accounting Standards Board from 2001).

China[3] could hardly have been more different from the UK in terms of commerce and accounting. It took a different route in the nineteenth century and, from 1949, discouraged private commerce. There was a lack of stock markets, and a uniform accounting system derived (via the Soviet Union) from early twentieth century Germany. However, as a result of a vast economic transformation from the 1990s onwards, China now has huge numbers of listed companies and (for them) a reporting system closely based on international financial reporting standards (IFRS). Within the next decade, China is expected to become again the home of the world's largest economy.

However, a fact of great importance for this report is that the great mass of companies (in any country) are *not* listed. Although unlisted companies in both countries are allowed to follow IFRS (or the system based on it), they mostly choose to follow the national accounting systems designed for them. This is the context of this report.

1 See: https://en.wikipedia.org/wiki/List_of_countries_and_dependencies_by_population (accessed 28.2.2021).

2 https://www.theguardian.com/cities/2016/dec/06/world-largest-cities-mapped-through-history-data-viz; https://en.wikipedia.org/wiki/List_of_largest_cities_throughout_history (accessed 28.2.2021).

3 I exclude here, Hong Kong SAR which was temporarily administered by Britain until 1997.

PREFACE AND ACKNOWLEDGEMENTS

(BY YUEDONG LI)

This report was commissioned by the Institute of Chartered Accountants in England and Wales (ICAEW) and supported by the ICAEW's Research Advisory Board. The objective of the research is explained in the Introduction to this report.

The project had an academic adviser: Professor Christopher Nobes of Royal Holloway College, University of London. The research was greatly assisted by a steering committee comprising the author, the advisor and three staff of the ICAEW: Alison Dundjerovic, Robert Hodgkinson and Gillian Knight.

I am also grateful for the time and advice of many interviewees (in China and the UK). These are listed in an Appendix.

I was also extensively helped by the China Accounting Standards Committee of the Ministry of Finance, ICAEW-China, the Chongqing and the Sichuan Institutes of Certified Public Accountants, and especially by Mark Billington and Candice Yu (respectively ICAEW's Managing Director, International, and Head of China), Qing Zhang and Lin Wang (respectively, Secretary General and Vice-President of the Chongqing Institute of Certified Public Accountants), and Li Gao, who works in the Chengdu Taxation Bureau of the State Administration of Taxation.

1. INTRODUCTION TO THE REPORT

This report examines several aspects of the financial reporting by small companies, with a focus on China and the UK:

A How should 'small company' be defined in this context?

B Who are the users of the financial reports of small companies, and what sort of information do they need?

C Comparing the GAAPs within and between China and the UK

D Changing GAAPs: changing the content of GAAP, and changing the GAAP being applied

Answering the first question above is a vital preliminary step towards answering the others. The second question could be rephrased as: what 'conceptual framework' is appropriate for small companies? The third question compares the various sets of generally accepted accounting principles (GAAPs) used in China and the UK. This includes examining the linkages between financial reporting and tax. This helps in a consideration of whether *IFRS for SMEs* could be adopted in China. The fourth question looks at how the content of any particular GAAP changes, and then at when a particular company changes the GAAP that it uses.

The report draws on several sources:

- the experiences of other countries and of international standard-setting;
- academic literature on the issues;
- interviews with experts on reporting by small companies; and
- the author's analysis of laws and standards.

The above four questions can be seen as part of a wider issue; and other aspects could be investigated later. For example, do the benefits of reporting outweigh the costs? The answer is less clear for small private companies than for large listed ones. This study contributes to understanding the **benefits**, by looking at the users and uses of the reports of small companies. The **costs** of reporting need further research. These costs include preparation and publishing (and sometimes auditing). The costs might be proportionately more onerous for small than for large companies. Another potential cost relates to the disclosure of information to competitors. Larger companies are more likely to be diversified geographically and by product, so the summarised disclosures in their published financial statements might not be as commercially sensitive as for small companies with fewer customers, projects and products. At the macro level of a whole economy, another approach to studying the cost/benefit issue would be to investigate whether or not great damage is caused in a country (such as the United States) where a large proportion of companies do no financial reporting at all, compared to a country (such as the UK) where all active companies must publicly file annual reports. Clearly, the UK system has extra costs, but are they outweighed by benefits?

2. STUDIES OF FOUR RELATED TOPICS

TOPIC A. HOW SHOULD 'SMALL COMPANY' BE DEFINED?

A.1 A look around the world

The literature on financial reporting contains discussion of 'differential reporting', under which certain entities do less reporting or use different accounting practices depending on various criteria, including size (Keasey and Short, 1990; Jarvis, 1996; Eierle, 2005). We use the abbreviation GAAP (generally accepted accounting principles) to describe a specific set of accounting rules, particularly of recognition and measurement. For example, *IFRS for SMEs* is a GAAP.

There is a long history of distinguishing between companies on the basis of their size. Whether this should affect accounting is a vital point for this report, as discussed below. However, let us begin with the size-based definitions used around the world for some purpose or other, not necessarily for financial reporting. Table A.1 shows a large number of examples. As may be seen, common criteria are the size of revenue and the number of employees. However, sectoral comparability can be a problem; eg, it is not easy to compare the 'revenue' of a bank with that of a shop.

If we want to study size criteria which **do** affect financial reporting, then the European Union is a good place to start. Table A.1 includes the European size criteria for differential reporting, expressed in terms of thresholds of revenue, employees and balance sheet. Smaller size can give exemptions from audit, publication, disclosures and the requirement to prepare consolidated statements. However, the central aspects of accounting (its GAAP, including recognition and measurement rules) are not affected. For example, the size criteria have no effect on the calculation of profits, taxable income or dividends.

In Europe now, the more important distinction is not based on a company's size but on its listing status. That is, under the EU Regulation of 2002, EU companies listed on EU regulated markets must use IFRS for their consolidated reporting. For other reporting, depending on the country, national GAAP is still required or allowed.

An even more stark distinction operates in the USA, where only SEC-registered companies are required by law to submit reports for audit and publication. Some other companies ('private companies') volunteer to report (or are required to by their bankers or owners), and they are allowed a different GAAP on some matters.

When writing the *IFRS for SMEs*, the IASB discussed the definition of SME at length (Ram and Newberry, 2013). The conclusion was that the IASB encountered particular difficulties when devising criteria that could apply internationally, so the exposure draft issued by IASB stated that, 'the IFRS for SMEs is intended for use by small and medium-sized entities (SMEs) and defined SMEs as entities that (a) do not have public accountability; and (b) publish general purpose financial statements for external users'. IASB also concluded that the definition of public accountability would be best left for local jurisdictions to decide (see paragraphs 69 and 70 of the *Basis for Conclusions* of the standard).

TABLE A.1 EXAMPLES OF SIZE CRITERIA

Country and defining institution	Definition	Indicator/s
Australia *(The Australian Bureau of Statistics)*	Micro: < 5 employees Small: 5-19 employees Medium: 20-200 employees	Employment
Canada *(Industry Canada)*	SMEs are defined as those enterprises having annual revenues between CAD 30,000 and CAD 5,000,000.	Annual revenue
Cambodia *(Ministry of Industry, Mines and Energy, Cambodia)*	Small: between 11 and 50 employees and have fixed assets of $50,000 to $250,000 Medium: between 51- 200 employees and fixed-assets of $250,000 to $500,000	Employment and fixed assets
European Union *(European Commission)*	Micro: less than 10 employees; turnover (sales) should not exceed EUR 2 million; and balance sheet total should not exceed EUR 2 million Small: 10-49 employees; turnover should not exceed EUR 10 million; and balance sheet total should not exceed EUR 10 million Medium: 50-249 employees; turnover should not exceed EUR 50 million; and balance sheet total should not exceed EUR 43 million	Employment, annual turnover and balance sheet total
Ethiopia	Micro: < 1,600 euros Small: < 40,000 euro	Turnover
Indonesia	Different definitions adopted by different institutions such as Statistics Indonesia; the Ministry of Industry and Trade, and the State Ministry of Cooperatives and Small and Medium Enterprises	Employment, Assets and Sales
Korea *(Small and Medium Business Administration, Korea)*	Different definitions for different sectors (see, http://www.sbc.or.kr/sbc/eng/smes/definition.jsp)	Employment, capital and annual turnover
Malaysia (Small and Medium Industries Development Corporation, Malaysia)	Different definitions for different sectors (see, http://www.smecorp.gov.my/v4/node/14)	Employment and annual turnover
Philippines (Department of Trade and Industry, Philippines)	Micro: 1-9 employees and assets up to PHP 3,000,000 Small: 10-99 employees and assets between PHP 3,000,001 and PHP 15,000,000 Medium: 100-199 employees and assets between PHP 15,000,001 and PHP 100,000,000	Employment and assets
Singapore (Ministry of Trade and Industry, Singapore)	Not more than 200 workers and annual turnover not exceeding 100 million Singapore dollars	Employment and annual turnover
South Africa	< 200 employees and turnover not exceeding 4 million euro	Employment and annual turnover

Country and defining institution	Definition	Indicator/s
United Kingdom	Micro: less than 10 employees; turnover (sales) should not exceed £632 000; and balance sheet total should not exceed £316,000. Small: 10-49 employees; turnover should not exceed £10.2 million; and balance sheet total should not exceed £5.1 million. Medium: 50-249 employees; turnover should not exceed £36 million; and balance sheet total should not exceed £18 million.	
United States of America (United States Small Business Administration)	Manufacturing firms: max. 500 employees. Wholesale trade firms: max. 100 employees. Agriculture: max. US$750,000 in average annual receipts. Retail trade and most service firms: max. US$6.5 million in average annual receipts. General and heavy construction (except dredging): average annual receipts of max. US$31 million.	Employment and Annual revenue
Vietnam (Agency for SME Development, Vietnam)	Up to 300 employees and capital investment not exceeding VND 10 billion	Employment and capital investment

Source: Bakr (2019), amended to add the UK after Brexit.

A.2 A brief outline of the current position in China and the UK

In China, the difficulty of establishing size criteria to define 'small' has led to the use of 16 different definitions for different sectors, perhaps the world's most complex set. These are shown in Appendix 1.

However, for this report, the key issue is whether size affects financial reporting rather than other issues such as tax. In China, for example, the size criteria do have relevance for accounting. They also affect other issues, such as tax rates and borrowing interest rates.

In China, a GAAP loosely based on IFRS was introduced in 2006 for the reporting of listed companies and unlisted financial institutions. This set of standards is called 'Accounting Standards for Business Enterprises' (ASBE, see more detail in Section C.1 later). This GAAP is also now required for large and medium-sized private companies. Small companies are also allowed to use ASBE, but the great mass of these companies use instead the 'Accounting Standard for Small Business Enterprises' (ASSBE). In Topic B below, we examine this in more detail, including the contents of the various GAAPs.

As noted above for Europe, the key distinction in the UK for financial reporting is not based on size but on listing status. Listed companies (and any unlisted financial institutions) must use IFRS for their consolidated reporting. All other reporting (irrespective of the size of the reporting company) is allowed to use IFRS but is also allowed to use UK GAAP. This comprises two parts: the Companies Act 2006 (based historically on EU Directives) and FRS 102 (based on *IFRS for SMEs*). For the law, the EU size criteria shown in Table A.1 still apply for some purposes. However, these affect disclosures, publication and audit, rather than the mainstream contents of GAAP.

Another key point relates to the word 'company'. In English law, there is a sharp distinction between businesses which are legal entities which are separate from their owners (companies) and other businesses run by persons or by partnerships of persons. In the UK, the legal requirement to do annual financial reporting (to shareholders and others) applies mainly to companies,[4] whereas the millions of partnerships and sole traders have no such reporting requirement. By contrast, the distinction is less clear elsewhere, such as in China and continental Europe. The ASSBE begins by saying that it applies to small 'corporate enterprises and natural person enterprises'. So, the ASSBE's scope is wide.

4 There are also requirements for limited liability partnerships.

A.3 A WORKING DEFINITION FOR THIS REPORT

To make progress in this report, it was necessary to limit its scope. At the top end, we exclude any company that is listed on a stock market and any financial institution. This fits with a universal conclusion that those companies must report using a country's most extensive requirements.

At the bottom end, we exclude 'micro-entities'. For some industries in China, these are defined as having fewer than 20 employees. In the EU, the threshold is 10 employees. It might make sense for these companies to have a simpler GAAP than that for SMEs or perhaps to be exempted from audit or publication. These issues need further investigation elsewhere. There is some relevant discussion in *IFRS for SMEs* (para. BC 71).

In order to identify the objectives of reporting by small companies, it is useful to have in mind some exemplar companies. Table A.2 gives three examples. We used these in our discussions with interviewees (see Section B.4).

TABLE A.2 ARCHETYPES OF SMES (THESE ARE UNLISTED COMPANIES; AND WE EXCLUDE MICROS)

Features	Company X	Company Y	Company Z
1. Number of owner-managers	2	5	1 (a subsidiary of a foreign group)
2. Number of other shareholders	0	12	0
3. Age of company	2 years	25 years	10 years
4. Business type	IT start-up	Food manufacturer	Pharmaceutical
5. Number of employees	35	200	200
6. Pension arrangements by the company (only relevant for the UK)	None	Some defined benefit (partially funded); some defined contribution	Defined contribution in a legally separate fund
7. Funding from:	Owners, family	Shareholders (including retained profit), bank	Parent, retained profit
8. Main assets on balance sheet	Nothing important	Factory, inventory, delivery vehicles	Factory, inventory, delivery vehicles
9. Profits; dividends	None yet	£500,000; 10% of profit	£500,000; 10% of profit
10. Prospects	Potentially large profit; possible sale of business to venture capitalists	Steady growth; aim to take over similar firms	Steady state

TOPIC B. WHO ARE THE USERS OF THE FINANCIAL REPORTS OF SMALL COMPANIES, AND WHAT SORT OF INFORMATION DO THEY NEED?

B.1 Potential users and uses; previous research

Users of accounting numbers might be divided into three types:

1. Managers inside the company
2. Outside users with special access, eg, the tax authorities (and, in China, other government agencies) or sometimes banks
3. Outside users of publicly available information

Standard-setters such as the IASB assume that they are dealing with the third type of user, even in the context of a standard such as *IFRS for SMEs*. However, the IASB notes that the first two types of users might find published financial reporting useful.

In academic studies of the users of SME reports, it seems that the users identified are internal or special access. Table B.1 summarises such studies. One might think that the first two types of users could make their own rules for the reporting that would best suit them. However, there are still three arguments for some form of standardisation:

- It suits users who receive reports from many companies, eg, the tax authorities and banks.
- It helps with the training of accountants and the users of accounting.
- If the SME rules are kept close to the mainstream rules, it makes it easier for a company to move from one system to the other, and helps with training.

TABLE B.1: COUNTRY EXAMPLE STUDIES OF THE MAIN USERS OF SMES' FINANCIAL STATEMENTS

Reference	Country	The main users of SMEs financial statements
Barker and Noonan (1996)	Ireland	Banks
Duc Son, Marriott, and Marriott (2006)	Vietnam	Tax authorities and governmental agencies followed by banks, which were considered as less important users
Van Wyk and Rossouw (2009)	South Africa	Owners, governmental agencies and bankers
Altarawneh (2015)	Jordan	Managers, banks and creditors, public authorities, analysts, followed by employees and shareholders, which were considered as less important users
Kiliç and Uyar (2017)	Turkey	Tax authorities
Wijekoon (2018)	Sri Lanka	Owner-managers, banks, and governmental agencies

Source: Bakr (2019).

B.2 The answer implied in IFRS for SMEs

The IASB believes that IFRS (rather than *IFRS for SMEs*) should be the standards applied by entities with public accountability (such as listed companies and other financial institutions). For entities *without* public accountability, IFRS or *IFRS for SMEs* can be appropriate. The IASB specifically excludes managers and the tax authorities as the intended users of information prepared under either IFRS or *IFRS for SMEs* (BC, paras. 50 and 53).

The IASB foresees the following types of user for financial statements prepared under *IFRS for SMEs* (BC para. 80):

- Banks
- Credit-rating agencies
- Suppliers and customers
- Non-manager shareholders
- It is interesting that employees are not mentioned.

The IASB did not write a separate conceptual Framework for *IFRS for SMEs*, but used the IFRS framework as a basis for writing *IFRS for SMEs* (BC, para. 97). This, of course, includes the cost-benefit trade-off, which led to the reduction in disclosures required by *IFRS for SMEs*.

A good review of academic literature related to these issues is provided by Evans et al (2005).

B.3 A new survey of expert opinion in the UK

ICAEW put together a roundtable of experts on reporting by small companies. The details of the participants are shown in Appendix 2. This sub-section contains the conclusions of the author, as enlightened by the members of the roundtable. For our discussion, we excluded listed companies and micro-companies. We had in mind three archetypes of unlisted company, as shown in Table A.2. Company X is a small start-up with little in the way of recognised assets. The young owners (or their parents) have contributed X's capital. Company Y is a family firm, run by members of the second generation of the founding family. It has traditional assets and it makes a steady profit; and it is therefore able to borrow from a bank. Company Z is a subsidiary of a UK, US or continental European group.

The sizes of the three archetypes are suggested in Table A.2, in terms of number of employees and level of profit. For Company Z, a wide range of these two parameters would not affect the conclusions. The size range in Table A.2 would fit within 'small and medium-sized' in the UK and would fit within 'small' in China.

In the context of the UK, we refer to all these companies as 'SMEs'. Within that, Company X is 'small' because of a low level of employees and balance sheet. It is allowed reduced disclosures and abbreviated statements, according to 'Section 1A' of FRS 102. It is exempt from audit.

The full range of potential users (as discussed in Section B.1) could apply for the financial statements of SMEs. However, in each case, there is a caveat. Table B.2 shows a list of potential users and what decisions they might make using accounting information. However, for each of these potential users/uses, there is a caveat which might undermine its importance. Let us take two examples from Table B.2:

- **Dividend calculations** (1(b) and 2(c)): The Companies Act contains a definition of distributable profit, the calculation of which is in practice based on a hugely complicated document (ICAEW, 2017). Thus, annual reports do not reveal the size of distributable profit, although its calculation (like that of taxable income) starts from the accounts. In practice, most UK companies do not pay out a large proportion of distributable profit, so dividend decisions might rest more on the assessment of expected cash flows and investment plans. These, of course, are also not available in the annual report.
- **Bank manager** (3(a)): The bank often asks for much more detailed information than is available in the annual report (eg, monthly management accounts). The bank might be more interested in the current values of the mortgageable assets of the company or of its owners.

TABLE B.2 USERS OF PUBLISHED ANNUAL REPORTS OF SMES (UK CONTEXT)

Potential users	Potential decisions	Caveats
1. Owner-managers	1(a) operational, strategic	One hopes that management has more detailed and up-to-date information than annual reports.
	1(b) dividends	The calculation of distributable profit is not visible in annual reports. Anyway, cash flow forecasts might be more useful.
	1(c) share price prediction	As point 1(a).
2. Other shareholders	2(a) checking on management	Some of these shareholders could ask for Board papers.
	2(b) strategic	As 2(a).
	2(c) dividend prediction	As 2(a); and some annual reports do not contain cash flow statements.
	2(d) share price prediction	As 2(a).
3. Bank manager	3(a) whether to lend (and how much); level of collateral; setting covenants	Bank managers can ask for internal accounting information or for meetings with company managers.
4. Suppliers; credit-rating agencies	4(a) reliability of the SME as a customer; setting credit terms	Section 1A reports are very thin.
5. Employees	5(a) appraisal of company before joining	Section 1A reports are very thin.
	5(b) continuing prospects for salaries and pensions	If the company's culture is to inform employees, they will not need annual reports.
6. HMRC (the tax authority)	6(a) accuracy of the tax return	HMRC already has the tax return, containing suitably adjusted accounting information.

In terms of the three example companies in Table A.2, Company Y has more potential users than do Companies X or Z. Company X has no outside shareholders and no bank borrowing. Also, its annual reports will be of little interest to HMRC (as it has no profit yet). Suppliers and employees will rely on individual negotiations with Company A because it has no recognised assets and no profit. Company Z has no non-group shareholders or lenders. Its suppliers and employees should still be wary of looking at its individual accounts because cash, other assets and profits can be moved around a group.

This analysis seems to be moving towards a conclusion that the published annual reports of SMEs are of little use, especially for Companies X and Z. This is not to say that bookkeeping or drawing up annual accounts is not necessary. Of course, that is required as the starting point for tax calculations, dividend calculations and (often) for informing private users such as the bank. The year-end exercise is important for such issues as counting inventory and remembering to look for impairments. But what about statutory published reporting?

There is a long-standing argument that publication is the company's price for gaining the limited liability which protects it from creditors. However, the requirement to do reporting was first implemented in the UK when easy registration of companies was allowed (by the Companies Act 1844) but these were not limited liability companies, which did not come in until the 1855 Act. The law requires the directors to report to the shareholders, not to the creditors; and, when auditors are appointed, the same applies. That is, annual reporting has not been mainly about protecting the creditors from bad companies, but protecting the shareholders from bad directors.

Furthermore, at first sight, the wrong party is paying because, despite the term 'limited liability company', it is not the company but the shareholders who gain limited liability. Nevertheless, it is clearly more efficient to impose a burden on the company than on the many shareholders, who will anyway pay in terms of increased costs and thus lower dividends. However, does the cost/benefit logic work? Company X's owners have very little to gain from limited liability, perhaps only non-payment of suppliers, and furthermore it does not buy much material. Company Z's single shareholder gains even less from limited liability. Z has little non-group finance. Its group would honour Z's commitments to employees and suppliers. So, Companies X and Z must pay for annual reporting but their owners gain little benefit from limited liability. By contrast, Company Y has large bank loans, large trade creditors and substantial unfunded pension obligations. In a crisis, Y's owners could benefit hugely from their limited liability, but they still pay the same rather small 'price' of annual reporting. So, this argument for reporting does not work well.

However, we are left with a subtle but powerful argument for annual published reporting: in modern jargon, it is a reality check. The discipline of published annual reporting forces management to think carefully about the numbers and the disclosures in its report. Publication then allows bank managers, employees and tax inspectors to check aspects of information obtained throughout the year in other ways.

Given that bookkeeping and annual preparation will be done anyway, the extra cost of publication might not be large, though strategic reports and narrative reporting are challenging for SMEs. This cost of reporting needs to be investigated but that is beyond the scope of this report.

Of course, the effectiveness of the discipline of reporting is affected by two major issues. First, effectiveness is greatly increased by external audit. But, secondly, effectiveness is undermined by the much reduced requirements for companies under Section 1A of FRS 102. It might be useful for regulators to look at this again. Perhaps the logical conclusion is that unaudited Section 1A reports might not be useful enough to justify the cost of publication.

B.4 A new survey of expert opinion in China

ICAEW in China found eight experts on reporting by small companies who were happy to be interviewed. The details of the participants are shown in Appendix 2. This sub-section contains the conclusions of the author, as enlightened by the members of the roundtable. For our discussion, we excluded listed companies and micro-companies. We had in mind the same three archetypes of unlisted company as for the UK, as shown in Table A.2. However, we deleted the information about pension arrangements because endowment insurance is compulsory in China, and the company pays to the social security bureau (a government agency) every month. After retirement, the employees go directly to the social security bureau to receive the retirement salary.

The potential users in China are somewhat similar to those for the UK in Table B.2, with the addition of government agencies.

From the eight interviewees, we found the following:

(a) Most interviewees (75 percent) did not fully agree with the current definition of small enterprises, and some think it should be based on listed status or on the output of companies instead of other measures of size.

(b) The main users are shareholders, potential investors, bank or other creditors, tax authorities and other government departments. Most interviewees (75 percent) thought that different sizes of enterprises are related to different development stages and that enterprises in different stages have different needs. The other two interviewees thought that the users are related to the type of enterprises and purpose of enterprises, such as tax reporting and income distribution.

(c) Most interviewees (75 percent) agree that the information provided by the small enterprises is useful, and users can use the information on financial statements to make decisions they want. They also mentioned that the management will prepare extra financial statements for themselves, which provide more detailed information, for making decisions. However, if a company just has one owner, they do not need to use the financial statements because they know the business of the enterprise very well. Further, one interviewee mentioned that generally financial statements are hardly used to make decisions, but are mainly used to cope with requirements of government departments.

(d) All agreed that some tax adjustments are usually necessary because of the differences between tax law and accounting standards, but the adjustments for small companies are very limited.

(e) All interviewees agree that if annual reporting were not required, the SMEs would still have to keep much the same accounting records for other non-public purposes (eg, tax, management, dividend calculations or private information to the bank). One interviewee added that, if the company just has one owner, the company does not need to keep the records for non-public purposes because the owner knows the company very well.

(f) All interviewees agreed that, for topics on which there are no relevant provisions in ASSBE small enterprises will usually adopt the relevant ASBE. In case of leases, the small enterprises usually regard leases as operating leases.

(g) All interviewees agreed that most small enterprises choose ASSBE instead of ASBE because of the higher implementation costs of the latter. However, if the small enterprises have particular needs or purposes, such as IPO planning, seeking investors or other financing requirements, they will choose ASBE.

B.5 Conclusions on users and uses

This report has discussed two key differences in scope between the Chinese and UK rules on accounting by small enterprises. First, the UK rules deal mainly with corporate entities, whereas the Chinese rules have the much wider scope of all types of business enterprise. Secondly, the UK rules sharply distinguish between listed and unlisted companies, whereas the real distinction in China is based on size. That is, as noted earlier, ASBE is required for all listed companies, unlisted financial institutions and all other unlisted entities except small ones. ASSBE is only allowed for small unlisted enterprises. However, as few small enterprises are listed, in effect the distinction between types of enterprise is based on size. There is a further matter, not yet discussed: the UK rules are only interested in external financial reporting whereas the Chinese rules require regulated accounting even without external reporting.

In the UK, the accounting standards (IFRS or FRS 102) do not tell companies to prepare financial statements. The standards become relevant when financial statements are to be issued (eg, given to the shareholders). The Companies Act says that unlisted companies should do this once per year. These companies might also wish to prepare (but not issue) monthly or quarterly statements, but that is an internal matter for them to decide; and such statements would not comply with the standards (eg, they might not include cash flow statements or most disclosures, and they might omit some of the year-end closing practices).

By contrast, the ASSBE (Article 87) says that small enterprises 'should prepare financial statements on a monthly or quarterly basis'. The word 'prepare' (rather than 'issue' or 'publish') is important, as is the fact that the enterprises are allowed to choose the frequency. So, ASSBE requires enterprises to prepare the interim statements even though they are not issued. This makes sense as part of forcing enterprises to manage themselves properly. It would also mean that the government (eg, the tax authorities) could inspect the interim statements if necessary. Companies generally send statements to the tax authorities quarterly and annually.

In terms of filing or publication, Chinese companies are required to file annual statements with the state's Business Administration System. These are not available to the public unless the company wishes it. However, the company's shareholders have access to the annual statements.

In terms of users, employees are seen as important users in UK, but not in China. Besides, China's small enterprises have a lot of government subsidies and support, and need to be supervised by relevant government departments. Therefore, in addition to the tax department, other government departments are also the main users of the statements.

In summary, interviewees in both countries saw limited use in the publication of financial statements by small enterprises. However, the preparation of the statements is a useful discipline for managers and it benefits other users, such as banks and the tax authorities.

TOPIC C. COMPARING THE GAAPS

C.1 Introduction to the comparisons

In order to understand the advantages and disadvantages of different GAAPs, it is necessary to examine the differences in their requirements. There are four GAAPs of interest for this report, as will now be explained. Two of the relevant GAAPs are IFRS and *IFRS for SMEs*. In the UK, strictly speaking the relevant GAAPs are instead UK-endorsed IFRS and FRS 102. However, for the purposes of this report, there are no important differences between UK-endorsed IFRS and IFRS, or between FRS 102 and *IFRS for SMEs*. As explained earlier, IFRS is required for the consolidated statements of listed companies. For any other reporting, IFRS or FRS 102 are both allowed.

Our other two GAAPs are Chinese. First, there is the set of standards called 'Accounting Standards for Business Enterprises'. These were issued in 2006, but have been amended several times, including in 2014 and 2017. Secondly, we have the 'Accounting Standard for Small Business Enterprises', as issued in 2011. Given the similarity in titles, there is some scope for confusion among readers, so we will use the abbreviations 'ASBE' and 'ASSBE/11', respectively.

ASBE is required for reporting by listed companies, financial institutions (whether listed or not) and any other unlisted companies which are not small or micro. The size criteria are complex, and are listed in Appendix 1. However, the 'small' category would include the sorts of companies used as exemplars in Table A.2. These small companies are *allowed* to use ASBE, but most prefer to use the ASSBE/11 which was designed for them.

A number of comparisons might be useful, particularly the differences between:

- IFRS and *IFRS for SMEs*
- IFRS and ASBE
- ASBE and ASSBE/11
- *IFRS for SMEs* and ASSBE/11

The first of these comparisons will be made immediately. The most important difference is the greatly reduced number of disclosures required by *IFRS for SMEs* compared to those required by IFRS. There are also some differences in GAAP, as shown in Table C.1, which is presented in the form of a table of contents of *IFRS for SMEs*, with significant differences from IFRS noted in square brackets and italics. The comparison in Table C.1 mostly applies also for the comparison of the two UK GAAPs: FRS 102 and UK-endorsed IFRS.

TABLE C.1 SECTIONS IN *IFRS FOR SMES* [DIFFERENCES FROM IFRS SHOWN IN SQUARE BRACKETS]

1	Small and Medium-sized Entities
2	Concepts and Pervasive Principles
3	Financial Statement Presentation [**No held-for-sale category of formerly non-current assets**]
4	Statement of Financial Position
5	Statement of Comprehensive Income and Income statement
6	Statement of Changes in Equity and Statement of Comprehensive Income and Retained Earnings. [**Statement of Comprehensive Income can be combined with Statement of Changes in Equity under certain circumstances**]
7	Statement of Cash Flows
8	Notes to the Financial Statements
9	Consolidated and Separate Financial Statements. [**Parents exempted from preparing investor statements; subsidiaries acquired with the intention of sale within one year should be excluded from consolidation**]
10	Accounting Policies, Estimates and Errors
11 12	Basic Financial Instruments and Other Financial Instruments Issues [**No available-for-sale category of financial assets (so, only amortised cost or marking-to-market)**]
13	Inventories
14	Investments in Associates. [**Associates and joint ventures can be carried at cost or fair value in consolidated statements (instead of using the equity method)**]
14	Investments in Joint Ventures
16	Investment Properties [**instead of the choice between cost and fair value, fair value should be used when and only when it can be measured without undue cost or effort**]
17	Property, Plant and Equipment [**No continuous review of residual values of assets for depreciation calculations**]
18	Intangible Assets other than Goodwill [**Development cost is an expense. Intangibles cannot be measured at fair value**]
19	Business Combinations and Goodwill. [**Goodwill and other intangibles with indefinite life to be amortised over a period of up to 10 years**]
20	Leases [**Leases split into operating and finance**]
21	Provisions and Contingencies
22	Liabilities and Equity
23	Revenue
24	Government Grants [**treated as income when receivable, rather than as an asset reduction or as deferred income**]
25	Borrowing Costs on construction [**expensed not capitalised**]
26	Share-based Payment
27	Impairment of Assets
28	Employee Benefits [**simplified calculation of pension obligation, eg, not taking account of expected salary increases**]
29	Income Taxes

30	Foreign Currency Translation [**no re-classification of foreign currency gains/losses as income when foreign subsidiaries are sold**]
31	Hyperinflation
32	Events after the End of the Reporting Period
33	Related Party Disclosures
34	Specialised Activities [**no requirement to use fair value for biological assets**]

Source: EY (2010, p.5) and Nobes and Parker (2020, p.359).

C.2 The present position in China, including differences between its two GAAPs

As mentioned in C.1 above, there are now two GAAPs in China, abbreviated here to ASBE and ASSBE/11. ASBE was loosely based on IFRS of the time, but has been updated to keep up with developments in IFRS, such as the major reforms to revenue recognition (IFRS 15) and to lease accounting (IFRS 16). Some differences between ASBE and IFRS in 2021 are listed in Table C.2. As may be seen, most of them relate to reduced use of fair value for the subsequent measurement of assets (abbreviated to 'SMFV' in the table).[5]

TABLE C.2 DIFFERENCES BETWEEN ASBES AND IFRS

	IFRS	ASBEs
1.	IAS 1 allows a by-function or by-nature income statement (para. 99)	ASBE 30 requires by-function (though 'by nature' note disclosures are required)
2.	IAS 7 allows the direct or indirect calculation of operating cash flows (para. 18)	ASBE 31 requires the direct method (though 'indirect' note disclosures are required)
3.	IAS 16 allows SMFV for property, plant and equipment (para. 29)	ASBE 4 does not allow SMFV
4.	IAS 38 allows SMFV for some intangibles (paras. 72, 78)	ASBE 6 does not allow SMFV
5.	IAS 40 allows SMFV for investment properties (para. 30)	ASBE 3 allows SMFV but constrains the choice (see Section 3.3 above)
6.	IFRS 6 allows SMFV for exploration and evaluation assets (para. 12)	ASBE 27 does not allow SMFV
8.	IAS 41 presumes that fair value can be measured reliably for biological assets whereupon SMFV is required (paras. 12 and 30)	ASBE 5 constrains the use of SMFV (see Section 3.3 above)
9.	IAS 41 requires a version of fair value for initial measurement of biological assets (para. 12)	ASBE 5 requires cost (Art. 6)
10.	IAS 36 requires reversals of impairment when appropriate, thereby sometimes involving fair value (para. 110)	ASBE 8 does not allow reversals of impairment (Art. 17)

Source: Nobes (2020).

5 By SMFV, we mean the continuous use of SMFV. We do not include the occasional use of fair value in the context of impairment (which is, of course, only used for downward adjustments).

The standard for small unlisted companies (called ASSBE/11 here) was designed for unlisted companies below a certain size (see the discussion in Topic A above). Three influences affected the content of ASSBE/11: previous Chinese standards for small companies, ASBE and tax rules. Compared to the ASBE, the ASSBE/11:

- is much shorter and easier to read;
- requires far fewer disclosure notes;
- omits many topics, such as debt restructuring, exchange of non-monetary assets, pensions, share-based payments, deferred tax, insurance contracts, oil & gas exploration, held-for-sale fixed assets; and
- has a number of simplifications, as now explained.

The main 'accounting' differences between ASSBE/11 and ASBE are set out in brief in Table C.3. There is less use of fair value under ASSBE/11, and judgement has been reduced in various ways. This lowers the cost of accounting, and it makes it easier for the tax authorities to check the calculation of profit. There are even examples where the rules are clearly designed to reduce (or postpone) expenses in order to keep profit higher, so as to raise more tax revenue. This is the effect of requiring straight-line depreciation and of using 'cost' rather than 'the lower of cost and NRV' for inventories. Another tell-tale point is that intangibles with uncertain lives must be amortised over *not less than* ten years. This can be contrasted with *IFRS for SMEs*, which requires *not more than* 10 years. So, ASSBE/11 is protecting taxable income, whereas *IFRS for SMEs* is protecting investors and others from seeing inflated profits.

Also, as a result of a recent change to ASBE (to bring it into line with IFRS 16), more leases are treated as finance leases under ASBE than under ASSBE/11.

The interviewees in China (see Section B.4) suggested that, for most companies which use ASSBE/11, few adjustments are needed to get from ASSBE/11 accounting numbers to the numbers needed for taxation. The typical adjustments relate to some types of staff-related expenses which are not tax-deductible.

TABLE C.3 MAIN DIFFERENCES BETWEEN ACCOUNTING UNDER ASBE AND ACCOUNTING UNDER ASSBE/11

Topic	ASBE	ASSBE/11
1. Inventory measurement	(a) Lower of cost and net realisable value (b) Losses on inventory may be recorded as operating or non-operating expense	(a) Cost (b) No impairment losses until sale, and the loss of inventory will be recorded as non-operating expense
2. PPE	(a) Many depreciation methods allowed (b) Depreciation estimates will be evaluated and adjusted (c) Impairment to be assessed when indications suggest	(a) Only straight-line depreciation allowed (b) Depreciation estimates cannot be changed after determined (c) No requirements on impairment
3. Investment property	Fair value option, if fair value can be continuously measured reliably	Cost basis only (because investment property is included in PPE)
4. Biological assets	Cost basis (details as for PPE above), except that fair value should be used if it can be continuously measured reliably	Cost basis (details as for PPE above)

5. Intangible assets	(a) Amortised unless uncertain life (b) Development costs meeting certain criteria must be capitalised (c) Amortisation estimates will be evaluated and adjusted (d) Provision for impairment is required	(a) Amortised; use more than 10 years if uncertain (b) Development costs meeting criteria may be capitalised (c) No evaluation and adjustment of amortisation estimates (d) No impairment losses until sale
6. Government grants for assets	Treated as deferred income or deducted from the asset	Deferred income
7. Treatment of leased assets by lessees	With a few exceptions, all leases treated like finance leases	Leases divided into finance and operating
8. Financial assets	(a) Equities, derivatives and some other items at fair value (b) Receivables reduced by estimated impairments.	(a) Cost basis (b) Receivables at face value until proven otherwise.
9. Hedge accounting	Allowed under certain conditions	Not allowed
10. Provisions for liabilities	Recognised when there is an obligation and probable outflow	Not accounted for until paid
11. Long-term liabilities	Discounted	Not discounted
12. Policy changes and corrections of errors	Retrospective method	Prospective method
13. Statement of Changes in Equity	Required	Not required
14. Segment reporting and related party disclosures	Required	Not required
15. Long-term equity investments	If significantly influenced, use the equity method. If not, use cost.	Measure at cost
16. Translation of foreign entities' financial statements	Use a mixture of current and historical exchange rates	Only use spot exchange rate on the balance sheet date
17. Revenue recognition on long-term contracts	As contract obligations are fulfilled	As work done under contract
18. Balance Sheet: detail to be shown	At least 14 types of assets and 12 types of liabilities	At least 9 types of assets and 7 types of liabilities.
19. Income Statements	At least 14 items	At least 8 items

Source: prepared by the author by examining the provisions of ASSBE/11 and comparing with the contents of the ASBE standards.

Our comparison of GAAPs concludes by looking at the differences between ASSBE/11 and *IFRS for SMEs* as shown in Table C.4. In summary, most of the differences are rather like the differences in Table C.3, given that ASBE is fairly close to IFRS, and *IFRS for SMEs* is also fairly close to IFRS.

TABLE C.4 KEY DIFFERENCES BETWEEN *IFRS FOR SMES* AND ASSBE/11

Topic	IFRS for SMEs	China's ASSBE/11
Property, plant and equipment	Assets at cost (less accumulated depreciation and impairment) or at their fair values (changes in fair values are in OCI).	Requires entities to carry assets at cost less accumulated depreciation. No rules on impairment.
	Provision for site-restoration and dismantling cost is required. The anticipated cost (after discounting) is added to the asset.	Provision for site-restoration and dismantling cost is not mentioned.
	Estimates of useful lives and residual values of fixed assets re-assessed at the end of each reporting period.	Once the service life and estimated net residual value of are determined, they shall not be changed at will.
Inventories	For inventories for which specific identification cannot be applied, a choice is available between FIFO or weighted average cost method. LIFO is prohibited.	Same.
	Net realisable value (NRV) estimated at each period end, and any reversal of write-down required.	Inventories measured at cost until sold or written off.
	Entities may capitalise borrowing cost in cost of inventories that take a substantial period to manufacture.	Capitalisation is required.
Intangible assets	Development cost is expensed.	Development cost may be expensed or, if it meets criteria, capitalised.
Investment properties	Allows accounting policy choice for subsequent measurement to carry investment property at either cost or fair value.	No accounting policy choice for subsequent measurement is mentioned, so the cost basis is used.
Deferred Tax	Company must recognise deferred tax on all temporary differences.	Not mentioned; and deferred tax not accounted for in practice.
	Measured at undiscounted expected outflows	Not mentioned.
Post-retirement employee benefits	Liability for defined benefit schemes determined through an actuarial valuation.	No rules, because after employees retire, they usually go to the social security bureau to get money.
Provisions	Recorded when there is a present obligation. Measured at discounted expected outflows.	Recorded in non-operating expenses when actually spent.

Financial assets	Financial instruments classified as: • At fair value through profit or loss (which includes trading and derivative instruments), or • or at cost Impairment of receivables based on probability of receipts.	The cost basis is required. Impairment recognised only when receivables written off.
Leases	Finance leases capitalised (those which transfer substantially all risks and rewards incident to ownership).	Same in majority practice. Based on contract.
	Operating lease rentals should be recognized in the income statement on a straight-line basis.	Same in majority practice.
Agriculture	With exceptions, measure biological assets at fair value, with gains/losses in profit and loss.	Based on cost.

Source: Prepared by the author.

C.3 The links between tax and financial reporting in China and the UK

The links between tax and financial reporting have been studied in detail for some countries. The starting point was the examination of German accounting by Haller (1992). Haller explains the German accounting rules and tax rules on many topics (eg, depreciation and inventory measurement), pointing out the strong influence of tax on German reporting, and that this implied that it would be difficult to harmonise accounting internationally. To put it simply, it is impossible for a country to adopt IFRS (or *IFRS for SMEs*) as its main accounting system unless tax calculations are separated from financial reporting. Otherwise, the IASB would control a country's tax calculations. For this reason, IFRS is not allowed for unconsolidated reporting in many countries, eg, France, Germany and Japan. Of course, for consolidated statements this problem goes away in most countries, because such statements are not relevant for tax.

Even without the international aspect, there are four types of potential problem caused by tax linkages: (i) if tax rests on accounting *judgements*, then companies are tempted to overstate expenses (eg, depreciation, impairment, bad debts), (ii) if tax rests on accounting *choices*, then companies make warped choices (eg, LIFO or avoiding fair value for investment properties), (iii) if tax rests on accounting *requirements*, they might add uncertainty into tax calculations (eg, fair value gains for investment property or agriculture), and (iv) if accounting rests on *tax rules*, then accounting is unlikely to be true and fair.

Lamb *et al* (1998) invented a technique for measuring the degree of tax influence in a country, so that countries could be compared. Lamb *et al* studied France, Germany, the UK and the US. Also, the technique enables a comparison over time within one country. Table C.5 shows the scoring system of Lamb *et al*, which can be applied topic by topic. For this report, we have scored accounting under ASSBE/11, which has not been done before. The detailed scoring for 20 accounting topics is recorded in Appendix 4. This is summarised in the right-hand column of Table C.6. As may be seen, there is a mixture of all the types of tax linkage except Case V.

TABLE C.5 TYPES OF CONNECTION OF TAX AND FINANCIAL REPORTING (FR) IN UNCONSOLIDATED STATEMENTS

Disconnection (Case I)	The different tax and FR rules (or different options) are followed for their different purposes.[1]
Identity (Case II)	Identity between specific (or singular) tax and FR rules.
Accounting Leads (Case III)	A FR rule is followed for financial reporting purposes, and also for tax purposes. This is possible because of the absence of a sufficiently specific (or singular) tax rule. The FR rule is precise, so there is little room for tax influence.
Accounting Leads (Case III†)	A FR rule is followed for financial reporting purposes, and also for tax purposes. This is possible because of the absence of a sufficiently specific (or singular) tax rule. The FR rule allows some judgement, so the FR number might be influenced by tax motivations.
Tax Leads (Case IV)	A tax rule or option is followed for tax purposes, and also for FR purposes. This is possible because of the absence of a sufficiently specific (or singular) financial reporting rule.
Tax Dominates (Case V)	A tax rule or option is followed for tax and FR purposes instead of a conflicting FR principle.

[1] Such disconnection will be recognised when distinct, independent and detailed tax and financial reporting operational rules exist. Even if measurement outcomes are essentially the same, the particular arena may still be characterised as Case I; the independence and completeness of the sets of rules 'disconnects' tax and accounting in an operational sense.

Source: adapted from Lamb *et al* (1998).

An international comparison is useful. In Table C.6, we also show the scores for the UK, as recorded previously by other researchers. The UK is seen in the literature as a good example of disconnection from tax, and there are indeed more examples of Case I (disconnection) for the UK. The overall position is clearer in a summary, as in Table C.7. That table ends with a summary score. A minus score shows widespread disconnection of financial reporting from tax. It can be seen that accounting under ASSBE/11 is somewhat disconnected from tax, but not as much as UK accounting is.

A wider international comparison is also useful. The right-hand column of Table C.7 shows the position for Germany in 1996, as recorded by previous researchers. This shows a hugely larger influence of tax on financial reporting. The position for ASSBE/11 is intermediate between the UK and Germany.

TABLE C.6 TAX LINKAGES IN TOPICS OF FINANCIAL REPORTING

Topic	UK GAAP	China ASSBE/11
1 Tangible asset measurement (cost or revaluation)	I	II
2 Depreciation (except leases)	I	IV
3 Impairment of tangible assets	I	IV
4 Lease classification	I	III†
5 Grants and subsidies	I	I
6 Development costs	I	I
7 Inventory flow assumptions	III†	III†
8 Inventory: net realisable value?	III†	III
9 Ordinary revenue	III	II
10 Long-term contract revenue	III	III†
11 Wages, salaries	III	II
12 Interest capitalisation	I	II
13 Foreign currency receivables/payables	III	III
14 Amortisation of intangibles (other than R&D)	III†	III†
15 Provisions (i.e. liabilities of uncertain timing or amount)	III†	III
16 Pension expenses	I	I
17 Policy changes, error correction	I	III
18 Fines, entertaining expenses	I	I
19 Financial asset measurement	I	III
20 Impairment of receivables	I	III

Source: UK scores adapted from Lamb *et al* (1998) and Gee *et al* (2010). China scores prepared by the author, as explained in Appendix 3.

TABLE C.7 INTERNATIONAL COMPARISON OF TAX LINKAGES

Case\Country	UK GAAP	China ASSBE/11	Germany 1996
Disconnection: I	12	4	1
Identity: II	0	5	0
Accounting Leads: III	4	6	6
Accounting Leads: III†	4	4	4
Tax Leads: IV	0	1	6
Tax Dominates: V	0	0	3
Total	20	20	20
Minimum index: Cases IV/V – Case I	-12	-3	8
Maximum index: Cases III†/IV/V – Case I	-8	1	12

Source: for the UK and China, derived from Table C.6. For Germany, from Gee *et al*. (2010) adjusted for a slightly different list of topics.

However, the Lamb *et al* technique was invented by UK-based researchers, who took it for granted that the rules for tax and those for financial reporting are made by different authorities. This was obviously true for the UK and the US at the time. For example, the UK tax rules are drafted by the Treasury and become Acts of Parliament, whereas accounting standards were issued by a private-sector committee whose conceptual framework specifically excluded tax calculations as a use of financial reporting. Even in Germany, although the state was in charge of both sets of rules, different ministries were involved, and the accounting rules pre-dated the existence of tax on corporate profits. By contrast, in China, the same Ministry[6] is in charge of both tax and financial reporting, so a totally different type of tax influence might apply: perhaps the accounting rules (especially those for small companies) are designed to make tax calculations easier and more reliable.

For example, the general stance against fair value in China (see Tables C.2 and C.4) simplifies accounting and removes a problem for tax calculations. There is also other evidence relating to specific topics in ASSBE/11:

- Inventories are measured at cost, rather than at the lower of cost and net realisable value (as in IFRS or ASBE). This reduces judgement, and the scope for cheating.
- Impairments of PPE wait until write-off or disposal, reducing judgement.
- Provisions for liabilities are not recorded on the basis of expected payments to satisfy present obligations, but they wait until amounts are spent.

These various examples are recorded as Cases II or III in Table C.6, because the companies do not choose their accounting policies by consulting tax law or by assessing the effects on tax bills. Nevertheless, the examples exhibit a different sort of tax influence: tax considerations affect the rule-making on financial reporting. So, Tables C.6 and C.7 *understate* the influence of tax on financial reporting under ASSBE/11.

Disconnections between tax and financial reporting allow accounting to reflect commercial reality. On the other hand, disconnections can create more work because adjustments must be made when tax calculations are performed. In practice, for most companies using ASSBE/11, there will be few or no adjustments necessary. Because of the differences between ASBE and ASSBE/11 (as discussed in Section C.2 above), there will be more adjustments needed for tax calculations by companies using ASBE.

This discussion suggests that one disadvantage of adopting ASBE (or adopting IFRS or *IFRS for SMEs*) for small companies in China would be greater adjustments for tax calculations.

6 The Ministry of Finance controls both accounting and tax standards, though the State Administration of Taxation draws up draft laws, formulates the policies for implementation of the standards, and collects tax.

TOPIC D. CHANGING THE CONTENT OF GAAPS, AND CHANGING THE GAAP BEING APPLIED

D.1 How and how often the content of GAAPs change

IFRS and IFRS for SMEs

The content of IFRS changes frequently. The pace of change has slowed since the first decade of the IASB, but even now there is some change to standards every year; either new standards or revisions to old ones. In 2018, major new standards on revenue recognition and financial instruments came into force. In 2019, a major new standard on lease accounting came into force.

By contrast, in order to reduce the costs for preparers, the *IFRS for SMEs* does not change often. It was issued in 2009 and not amended at all until 2015. The IASB sent out a 'Request for Information' about changing the standard, in 2020. The key issue is whether to adjust the standard for the changes to IFRS mentioned in the previous paragraph.

UK GAAP

As explained earlier, UK-endorsed IFRS is required for some purposes in the UK. It largely follows the content and timing of changes to IFRS. The process is in the control of the UK Endorsement Board, which is an independent body under the supervision of a Ministry.

The standard available for unlisted companies (FRS 102) is loosely based on *IFRS for SMEs.* The UK's Financial Reporting Council (soon to be replaced by the Audit, Reporting and Governance Authority) is in charge of this. FRS 102 was issued in 2013. FRC plans to make significant revisions every five years, although very small revisions are issued in most years.

China

The Accounting Department of the Ministry of Finance is in charge of establishing accounting standards. The ASBE (based loosely on IFRS) was issued in 2006. No changes were issued until 2014. Since then, several major changes have been made, largely to keep up with amendments to IFRS. Most standards are now substantially converged with IFRS (see Section C.2).

The ASSBE/11 was issued in 2011 to replace a previous standard which had been issued in 2004. There have been no changes to the ASSBE/11 so far. The Ministry will ask the opinions of users of accounting standards about any necessary changes to the standard. When the Ministry thinks it is necessary to modify the accounting standards, it will set up a revision project, with the support of technical staff. They will make drafts and listen to the opinions of various parties, such as academics, managers, accountants and auditors. At present, there are no plans for revision. This report has been given to the Ministry for use in future revisions.

D.2 How and when a company can or must change its GAAP

Mandatory adoption by a country

When a *country* newly adopts a GAAP for certain purposes, the relevant *companies* must of course comply with the new requirement. For example, that happened for listed companies in the UK with the adoption of IFRS in 2005, and it happened in China for listed and larger companies when ASBE was adopted after its issue in 2006.

A company changing its status

When a Chinese or UK company changes its status, it might be required to change its GAAP. For example, if a Chinese company breaches the size limit for ASSBE/11 (or becomes listed), it must newly adopt ASBE. Given that this happens fairly often, it is useful that the two GAAPs operating in a country are as close as possible, in order to minimise disruption.

Choices of GAAP

In some cases, a company has a choice of GAAPs. For example, a small unlisted company can choose between IFRS and FRS 102 in the UK, and between ASBE and ASSBE/11 in China. In both countries, the rules allow a change to IFRS/ASBE but not the other way round (except under special circumstances).

SUMMARY AND CONCLUSIONS

SUMMARY OF FINDINGS

The findings of this report include the following:

- Many countries distinguish between companies by their sizes. This does not always affect the GAAP used. It can also involve exemptions from audit or publication, or special tax rates.
- In China, the size of an entity is effectively the main criterion determining its required GAAP; whereas in the UK the main distinction is based on listing status.
- Chinese accounting rules encompass all types of entities whereas UK rules apply mainly to limited liability companies.
- Chinese rules (unlike UK rules) require small enterprises to prepare financial statements even if they are not published.
- Academic research identifies a range of users for reports of small companies; and government agencies (including tax authorities) are seen as important.
- By contrast, the conceptual framework lying behind *IFRS for SMEs* sees investors as the prime users.
- This report excludes consideration of micro companies. It uses three exemplar companies within the size range of ‘small’. This report’s survey of UK auditors found limited direct use of reports produced by such entities, but confirmed the importance of the discipline imposed by requirements for record-keeping and annual preparation of financial statements.
- British Interviewees saw limited use in the publication of the financial statements of small companies, but the annual discipline is good for managers, the tax authorities and lenders.
- Chinese interviewees identified managers, banks and government departments (including the tax office) as users of financial statements. Published statements could be useful for potential investors.
- In China, the ASSBE/11 is indeed directed less towards investors and more towards ensuring good order and assisting managers and tax collectors.
- This report examined and compared four GAAPs: IFRS, FRS 102, ASBE and ASSBE/11. IFRS and ASBE are fairly similar. For most companies for most topics, FRS 102 (being based on *IFRS for SMEs*) is a similar GAAP to IFRS but with less disclosure. ASSBE/11 is noticeably different from the other GAAPs.
- UK GAAP is disconnected from tax on many topics. ASSBE/11 is much closer to the tax rules.
- ASSBE/11 and FRS 102 do not change very often, compared to ASBE or IFRS.
- Small companies are allowed to use ASBE or IFRS. If a Chinese company grows beyond the ‘small’ size criteria (or if it becomes listed), it must move to ASBE. If a UK unlisted company becomes listed, it must move to IFRS.

CONTRASTS AND LESSONS

This report has discussed several key differences between China and the UK in the field of accounting by small enterprises, including:

- The UK rules deal mainly with corporate entities, whereas the Chinese rules have the much wider scope of all types of business enterprise.
- The UK rules sharply distinguish between listed and unlisted companies, whereas the Chinese rules put larger unlisted enterprises with listed companies, leaving small unlisted enterprises as the special case.
- The UK rules on how to do accounting are restricted to the annual financial reports which are issued to external parties, whereas the Chinese rules require regulated preparation of monthly or quarterly statements which are not issued externally.

The different scopes of FRS 102 and ASSBE/11 can be summarised as follows (leaving aside those minority of enterprises which choose to comply with full-scale reporting under IFRS or ASBE):

- FRS 102 deals mostly with annual financial reporting (to outsiders) by unlisted companies.
- ASSBE/11 deals with the preparation of financial statements several times per year (whether published or not) by small enterprises (whether incorporated or not).

The contrast between these very different approaches raises questions about whether one country could learn anything from the other country. Can we identify insights for practitioners, regulators, standard-setters or for broader economic policy? For example:

1. In each country, are the accounting rules and their scope suitable for the intended users and uses of the accounting? Would there be advantages for China in reducing the scope of its accounting requirements, or for the UK in extending the scope?
2. Would there be advantages for China in reducing the connection of tax and accounting, or for the UK in increasing the connection?
3. Would there be advantages for China if it adopted (or adapted) *IFRS for SMEs* as has been done in the UK and many other countries?

These questions are now examined.

The rules and their scope

The major China/UK differences in the scopes of the rules were discussed at the beginning of this section. Do they make sense?

ASBE applies to listed companies and to large and medium-sized unlisted enterprises. This removes the need for companies to change GAAP when they move from being unlisted to listed. Of course, instead there is a cut-off between small and medium-sized. When a company makes that move, it must change its accounting rather dramatically from ASSBE/11 to ASBE, as explained in Section C.2.

This does leave a key question for regulators in China. Why is ASBE imposed on medium-sized and large unlisted enterprises? Although this report did not study such entities, it seems likely that the mix of users would be similar to that for small enterprises. Further research could check that. If the assumption is true, then ASSBE/11 might be more suitable than ASBE for any unlisted entity because ASSBE/11 is cheaper to implement and it is closer to the tax rules which the companies must anyway follow for tax purposes.

For the UK, different questions arise. The conceptual framework which underlies both IFRS and *IFRS for SMEs* assumes that financial reporting is *not* for the entity's managers and *not* for the tax authorities. However, the literature and some of our interviewees consider that these might be the main users of SME accounting. There is thus a mismatch. UK regulators might consider three questions: (i) Is published financial reporting by unlisted entities worth its cost? (ii) Should FRS 102 be moved more towards the private needs of the management and the tax system rather than being designed to give a published true and fair view for investors? (iii) Should internal accounting requirements be imposed on unincorporated entities (as in China and much of the European Union), for the benefit of the good running of the whole economy, including giving information to the managers and the tax authorities?

Is tax connection suitable?

The previous paragraph has mentioned tax connections. For IFRS and ASBE, the assumption is that financial reporting is not designed to suit the tax authorities. Furthermore, it *should not* be. This is because a close linkage between tax and financial reporting would bring several disadvantages, as noted in Section C.3. We can thus be content that there are many disconnections between tax and financial reporting under IFRS in the UK and under ASBE in China. By contrast, different conclusions apply for unlisted entities, perhaps irrespective of their size. Where financial reports are little used by investors or are not even published, there is an argument for conformity between tax and accounting. ASSBE/11 has followed this approach to some extent, though an even closer link might make sense, and has been seen elsewhere in the past (eg, in Germany). As noted above, a closer link might be considered by the UK regulators.

Should China adopt *IFRS for SMEs* (or adapt it as in the UK)?

The main advantage to the UK of having approximately adopting *IFRS for SMEs* (instead of previous UK GAAP) is that it limits the differences between the two types of GAAP operating in the country. This is helpful in the training and work of preparers, auditors and users. It is also helpful for a company which moves from one GAAP to the other because its status changes.

Also, in the UK, it had become cumbersome to keep old UK GAAP up-to-date. In some other countries (eg, Sweden), the approximate adoption of *IFRS for SMEs* replaced an old national GAAP which was out-of-date, did not cover some major topics, and allowed too much flexibility.

International comparability is a key reason for adopting IFRS among listed companies around the world. This is clearly less important for unlisted entities, many of which have no foreign users. Nevertheless, many SMEs are subsidiaries of foreign groups, and foreign investors are interested in some other SMEs.

At first sight a major disadvantage of adopting *IFRS for SMEs* might be the cost of implementation. However, the literature suggests that this is largely a one-off cost, which is not important in the long run.

Does this all add up to a reason for China to consider replacing ASSBE/11 with *IFRS for SMEs*? Given the answers to questions of scope and tax linkage above, the balance of argument suggests that this would not be useful.

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APPENDICES

APPENDIX 1 – DEFINITIONS OF SMES IN CHINA

SMEs are divided into three types: medium-sized, small-sized and micro-sized. The specific definitions are formulated according to the employees, operating income, total assets and other indicators of the enterprise, combined with the characteristics of the industry.

Agriculture, forestry, animal husbandry and fishery: Small and medium-sized enterprises are those with an operating income of less than 200 million yuan. Among them, those with an operating income of 5 million yuan or more are medium-sized enterprises, those with an operating income of 500,000 yuan or more are small enterprises, and those with an operating income of less than 500,000 yuan are micro enterprises.

Manufacturing Those with less than 1,000 employees or less than 400 million yuan of operating income are SMEs. Among them, medium-sized enterprises have 300 employees or more with an operating income of 20 million yuan or more; small enterprises have 20 employees or more with an operating income of 3 million yuan or more; micro enterprises have less than 20 employees with an operating income of 3 million yuan or less.

Construction SMEs have an operating income of less than 80 million yuan or total assets of less than 80 million yuan. Among them, medium-sized enterprises have an operating income of 60 million yuan or more and total assets of 50 million yuan or more; small enterprises have an operating income of 3 million yuan or more and total assets of 3 million yuan or more; micro enterprises have an operating income of less than 3 million yuan or total assets of less than 3 million yuan.

Wholesale Those with less than 200 employees or with an operating income of less than 400 million yuan are SMEs. Among them, medium-sized enterprises have 20 or more employees with an operating income of 50 million yuan or more; small enterprises have 5 or more employees with an operating income of 10 million yuan or more; micro enterprises have less than 5 employees or an operating income of 10 million yuan or less.

Retail Those with less than 300 employees or with an operating income of less than 200 million yuan are SMEs. Among them, medium-sized enterprises with 50 employees or more and an operating income of 5 million yuan or more; small enterprises with 10 employees or more and an operating income of 1 million yuan or more; micro enterprises with less than 10 employees or an operating income of 1 million yuan or less.

Communications and transportation Those with less than 1,000 employees or with an operating income of less than 300 million yuan are SMEs. Among them, medium-sized enterprises have 300 employees or more with an operating income of 30 million yuan or more; small enterprises have 20 employees or more with an operating income of 2 million yuan or more; micro enterprises have less than 20 employees with an operating income of 2 million yuan or less.

Warehousing Those with less than 200 employees or with an operating income of less than 300 million yuan are SMEs. Among them, medium-sized enterprises with 100 employees or more and an operating income of 10 million yuan or more; small enterprises with 20 employees or more and an operating income of 1 million yuan or more; micro enterprises with less than 20 employees or an operating income of 1 million yuan or less.

The postal industry Those with less than 1,000 employees or with an operating income of less than 300 million yuan are SMEs. Among them, medium-sized enterprises have 300 employees or more with an operating income of 20 million yuan or more; small enterprises have 20 employees or more with an operating income of 1 million yuan or more; micro enterprises have less than 20 employees with an operating income of 1 million yuan or less.

Accommodation Those with less than 300 employees or with an operating income of less than 100 million yuan are SMEs. Among them, medium-sized enterprises have 100 or more employees with an operating income of 20 million yuan or more; small enterprises have 10 or more employees with an operating income of 1 million yuan or more; micro enterprises have less than 10 employees or an operating income of 1 million yuan or more.

Catering Those with less than 300 employees or with an operating income of less than 100 million yuan are SMEs. Among them, medium-sized enterprises have 100 or more employees with an operating income of 20 million yuan or more; small enterprises have 10 or more employees with an operating income of 1 million yuan or more; micro enterprises have less than 10 employees or an operating income of 1 million yuan or more.

Information transmission industry Those with less than 2,000 employees or with an operating income of less than 1 million yuan are SMEs. Among them, medium-sized enterprises have 100 or more employees with an operating income of 10 million yuan or more; small enterprises have 10 or more employees with an operating income of 1 million yuan or more; micro enterprises have less than 10 employees or an operating income of 1 million yuan or less.

Software and information technology services Those with less than 300 employees or with an operating income of less than 100 million yuan are SMEs. Among them, medium-sized enterprises have 100 or more employees with an operating income of 10 million yuan or more; small enterprises have 10 or more employees with an operating income of 500000 yuan or more; micro enterprises have less than 10 employees or an operating income of 500000 yuan or more.

Real estate development and operation SMEs are those with operating income less than 2 million yuan or total assets less than 100 million yuan. Among them, medium-sized enterprises have an operating income of 10 million yuan or more and total assets of 50 million yuan or more; small enterprises have an operating income of 1 million yuan or more and total assets of 20 million yuan or more; micro enterprises have an operating income of less than 1 million yuan or total assets of less than 20 million yuan.

Estate management Those with less than 1,000 employees or with an operating income of less than 50 million yuan are SMEs. Among them, medium-sized enterprises have 300 employees or more with an operating income of 10 million yuan or more; small enterprises have 100 employees or more with an operating income of 5 million yuan or more; micro enterprises have less than 100 employees or an operating income of 5 million yuan or more.

Leasing and business services Those with less than 300 employees or total assets less than 120 million yuan are SMEs. Among them, medium-sized enterprises have 100 employees or more and total assets of 80 million yuan or more; small enterprises have 10 employees or more and total assets of 1 million yuan or more; micro enterprises have less than 10 employees or total assets of 1 million yuan or less.

Other industries Those with less than 300 employees are SMEs. Among them, those with 100 or more employees are medium-sized enterprises; those with 10 or more employees are small enterprises; those with less than 10 employees are micro enterprises.

APPENDIX 2 – DETAILS OF THE INTERVIEWS ABOUT THE USERS OF SME REPORTS

UK Interviews

The UK interviews took the form of a roundtable, organised by the ICAEW. It took place on 19 March 2021. The following attended, plus Alison Dundjerovic (ICAEW, in the chair), Yuedong Li and Christopher Nobes.

Name	Role	Firm
Sarah Flint	Sole practitioner	Sole practitioner
Sophie Parkhouse	Partner	Albert Goodman
Paul Creasey	Audit Partner	Azets
Bhavita Shah	Head of Audit and Assurance	Aventus Partners
James Hadfield	Partner	Menzies
Simon Kettlewell	Director	HAT group
Eunice McAdam	Partner	Saffery Champness

The topic is discussed in Section B.4 of the report. The views expressed there are not necessarily those of all, or of any, of the participants in the roundtable. They are the views of the author, as enlightened by the roundtable.

China interviews

The interviews in China were conducted on 14 May, 17 May, 19 May, 20 May, 2 June, 4 June and 9 June by Yuedong Li, with the following:

Name	Role	CPA Firms
WANG Zhangli	Partner, CPA	PAN-CHINA CPA
WAN Xianjin	Partner, CPA	Chongqing Kanghua Certified Public Accountants LLP
HAN Shiming	Senior Manager, CPA	WUYIGE Certified Public Accountants LLP
ZHU Yuqing	Deputy Chief Accountant, CPA	Leshan Zhengyuan Certified Public Accountants LLP
XU Binglun	Partner, CPA	Sichuan Dewen Certified Public Accountants LLP
ZHOU Gang	Senior Manager, CPA	Daxin Certified Public Accountants (Special General Partnership) , Sichuan Branch
LIU Zhuoqin	Partner, ICAEW-FCA	PROWISE CPA LTD
DAI Qing	Partner,CPA,CFA	BDO China SHULUN PAN CPAs LLP, Chongqing Branch

INTERVIEW QUESTIONS

We began by supposing that 'SMEs' really means unlisted companies. Is there a typical size for such companies in the UK? If not, do we need to ask our questions separately for several size categories?

1. Is there a short list of types of user (which would account for most use)? If so, who are they? If not, which groups are the most prevalent?
2. For the two or three most important groups of users, what decisions do they take (for which the published accounts are useful)? If not useful for decisions, how else are the reports important?
3. Should we expect a different mix of users for different sizes of SME? For example, are banks big users for very small companies but not for medium-sized (or vice versa)?
4. Can SMEs generally use their financial statements for tax filing without much adjustment?
5. Do owner/managers use the annual reports to help them manage?
6. If annual reporting were not required, would the SMEs have to keep much the same accounting records for other non-public purposes (eg, tax, management, dividend calculations, private information to the bank)?

For the Chinese interviews, we also asked the following:

1. Do you think the current definition of small company is appropriate?
2. When there are no relevant provisions in ASSBE/11, will small enterprises adopt ASBE, such as for leasing?
3. In practice, how many small enterprises are willing to use ASBE instead of ASSBE/11? Can you explain why?

APPENDIX 3 – DIFFERENCES BETWEEN ASBE[a] AND ASSBE/11

Topic	*ASBE*	*ASBBE/11*
1. Inventory measurement	(a) Lower of cost and net realisable value (ASBE/06 No.1, Article 15) (b) The loss of inventory may be recorded in non-operating income or expense, and also may be recorded in cost of goods sold (ASBE/06 No.1, Article 21)	(a) Cost (ASSBE/11, Article 12) (b) No impairment losses until sale, the loss of inventory is recorded in non-operating income or expense (ASSBE/11, Article 12)
2. PPE	(a) Many depreciation methods allowed (ASBE/06 No.4, Article 14) (b) Service life, estimated net residual value and depreciation method should be reviewed each year and make some adjustment if necessary (ASBE/06 No.4, Article 19) (c) Impairment to be assessed when indications suggest (ASBE/06 No.4, Articles 18,21) (d) The subsequent expenditure related to fixed assets shall be included in the cost of fixed assets or in the current profit and loss when it occurs (ASBE/06 No.4, Article 6)	(a) Only straight-line depreciation allowed (ASSBE/11, Article 30) (b) Once the depreciation method, service life and estimated net residual value of fixed assets are determined, they shall not be changed at will (ASSBE/11, Article 30) (c) No requirements on impairment, the loss of inventory is recorded in non-operating income or expense (ASSBE /11, Article 34) (d) Subsequent expense may be recorded in current profit and losses, or recorded in cost of PPE, or recorded in long-term unamortized expenses. (ASSBE/11, Article 33)
3. Investment property	Fair value option for subsequent measurement, if value can be continuously measured reliably (ASBE/06 No.3, Article 10)	Cost basis only (because investment property is included in PPE) (ASSBE/11, Article 28)
4. Biological assets	(a) The rule applies to consumptive biological assets, productive biological assets and public welfare biological assets (ASBE/06 No.5, Article 3) (b) Fair value required but only if value can be continuously measured reliably (ASBE/06 No.5, Article 22) (c) The depreciation methods of productive biological assets include life average method, workload method, output method, etc (ASBE/06 No.5, Article 18) (d) Service life, estimated net residual value and depreciation method should be reviewed each year and make some adjustment if necessary(ASBE/06 No.5, Article 20) (e) Impairment for the consumptive biological assets and productive biological assets is needed, and no provision for impairment of public welfare biological assets (ASBE/06 No.5, Article 21)	(a) The scope of the rule just applies to productive biological assets (ASSBE /11, Article 35) (b) Cost basis (ASSBE/11, Article 36) (c) Straight-line method (ASSBE/11, Article 37) (d) Once the service life, estimated net residual value and depreciation method of productive biological assets are determined, they shall not be changed at will (ASSBE/11, Article 37) (e) No requirements on impairment

5. Intangible assets	(a) Amortised unless uncertain life, and the amortization method of intangible assets selected by an enterprise shall reflect the expected realization mode of economic benefits related to the intangible assets. If it is impossible to reliably determine the expected realization method, the straight-line method shall be used for amortization (ASBE/06 No.6, Article 17) (b) The expenditure of research and development projects within an enterprise should be distinguished between research stage expenditure and development stage expenditure. The expenses incurred in the research stage shall be included in the current profits and losses when they occur. Expenditures in the development stage may be included in current profits and losses or be included in the cost of intangible assets (ASBE/06 No.6, Articles 7,8,9) (c) The enterprise shall review the service life and amortization method of intangible assets with limited service life at least at the end of each year and make the adjustment if necessary (ASBE/06 No.6, Article 21) (d) Provision for impairment is required (ASBE/06 No.6, Article 20)	(a) Amortised using straight-line method, use more than 10 years if uncertain (ASSBE/11, Article 41) (b) only mentions expenditure for development phase, expenditures in the development stage may be included in current profits and losses or be included in the cost of intangible assets (ASSBE/11, Articles 39,40) (c) Once the service life, estimated net residual value and depreciation method are determined, they shall not be changed at will (ASSBE/11, Articles 39,40) (d) No impairment losses until sale (ASSBE/11, Article 42)
6. Government grants for assets	Treated as deferred income or deducted from the asset (ASBE/17 No.16, Article 8)	Deferred income (ASSBE/11, Article 69)
7. Leased assets in the statements of lessees	With a few exceptions, all leases treated similarly as finance leases by lessees (ASBE/17 No.21, Articles 16,17	Leases divided into finance and operating (no requirements in ASSBE/11, so accountants usually use ASBE/06, No.21, Article 4 which divides into financial and operating leases
8. Financial assets	(a) Equities, derivatives and some other items at fair value (ASBE/17 No.22, Article 33) (b) Receivables reduced by estimated impairments (ASBE/17 No.22, Article 46)	(a) Cost basis (ASSBE/11, Article 9) (b) No requirement about impairment. Receivables at face value until proven otherwise. The impairment loss of receivables and prepayments shall be included in non-operating expenses when it actually occurs (ASSBE/11, Article 10)
9. Hedge accounting	Allowed under certain conditions (ASBE/17 No.24)	Not allowed
10. Provisions for liabilities	Recognised when there is an obligation and probable outflow(ASBE/06 No.13, Article 4)	Not accounted for until paid (ASSBE/11, Article 47)

11. Long-term liabilities	Discounted (ASBE/06 No.17, Article 7)	Not discounted (ASSBE/11, Article 52)
12. Policy changes and corrections of errors	Retrospective method (unless impracticable) (ASBE/06 No. 28, Art. 6)	Prospective method (ASSBE/11, Art. 88)
13. Statement of Changes in Equity	Required (ASBE/14 No. 30, Art. 2)	Not required (ASSBE/11, Art. 79)
14. Segment reporting and related party disclosures	Required (ASBE/14 No. 35)	Not required
20. Long term equity investment	(a) The definition of long-term equity investment focuses on control or significant influence (ASBE/14 No. 2, Article 2) (b) Equity method for holdings significantly influenced (option to use fair value for holdings by investment entities). Other holdings at cost. (ASBE/14 No. 2, Articles 7, 9)	(a) The definition of long-term equity investment focuses on the time the enterprise holding this investment (ASSBE/11, Art. 22) (b) Cost method for accounting treatment (ASSBE/11, Art. 24)
21. Foreign currency translation of foreign entities' financial statements	The assets and liabilities in the balance sheet are translated at the spot exchange rate on the balance sheet date. The owner's equity items are translated at the spot exchange rate at the time of occurrence except for the "undistributed profits". The income and expense items in the income statement can be converted at the spot exchange rate on the transaction date or similar one (ASBE/06 No. 19, Article 12)	Only use spot exchange rate on the balance sheet date to translate all items (ASSBE/11, Art. 77)
22. Revenue	The enterprise should recognize the revenue when it fulfils the performance obligation in the contract (ASBE/17 No. 14, Article 4)	Generally, small enterprises should recognize the income from selling goods when they issue goods and receive payment or the right to receive payment (ASSBE/11, Art. 59)

23. Balance Sheet: detail to be shown	(a) The asset category in the balance sheet shall at least separately list the items reflecting the following information: (1) monetary capital; (2) financial assets measured at fair value and the changes of which are included in the current profits and losses; (3) accounts receivable; (4) prepayment; (5) inventory; (6) non-current assets classified as held for sale and assets in disposal group classified as held for sale; (7) non-current assets classified as held for sale, available for sale financial assets; (8) held to maturity investment; (9) long term equity investment; (10) investment real estate; (11) fixed assets; (12) biological assets; (13) intangible assets; (14) deferred income tax assets (ASBE/14 No. 30, Article 23) (b) The liabilities in the balance sheet shall at least separately list the items reflecting the following information: (1) short-term borrowings; (2) financial liabilities measured at fair value and the changes of which are included in the current profits and losses; (3) accounts payable; (4) advances received; (5) employee compensation payable; (6) taxes payable; (7) liabilities in the disposal group classified as held for sale; (8) long-term loans; (9) bonds payable; (10) long term accounts payable; (11) estimated liabilities; (12) deferred income tax liabilities (ASBE/14 No. 30, Article 25)	(a) Assets in the balance sheet shall at least separately list the items reflecting the following information: (1) monetary capital; (2) receivables and prepayments; (3) inventory; (4) long term bond investment; (5) long term equity investment; (6) fixed assets; (7) productive biological assets; (8) intangible assets; (9) long term unamortized expenses (ASSBE/11, Art. 80) (b) The liabilities in the balance sheet shall at least separately list the items reflecting the following information: (1) short-term loans; (2) accounts payable and advances received; (3) employee salaries payable; (4) taxes payable; (5) interest payable; (6) long-term loans; (7) long-term accounts payable (ASSBE/11, Art. 80)
24. Income Statement: detail to be shown	(c) The Income statement shall at least separately list the items reflecting the following information, unless otherwise specified in other accounting standards: (1) operating income; (2) operating costs; (3) business taxes and surcharges; (4) management expenses; (5) sales expenses; (6) financial expenses; (7) investment income; (8) profit and loss from changes in fair value; (9) asset impairment loss; (10) profit and loss from disposal of non-current assets; (11) income tax expenses; (12) net profit; (13) other comprehensive income (14) total comprehensive income (ASBE/14 No. 30, Article 31)	(c) The income statement shall at least separately list the items reflecting the following information: (1) operating income; (2) operating costs; (3) business taxes and surcharges; (4) sales expenses; (5) management expenses; (6) financial expenses; (7) income tax expenses; (8) net profit (ASSBE/11, Art. 81)

Source: prepared by the author. Note a = Some ASBE standards have been amended since issue in 2006. In this detailed table, the standards are shown with their dates of issue, e.g. 'ASBE/17' is the version issued in 2017.

APPENDIX 4 – DETAILS OF THE SCORING OF THE TAX LINKAGES OF ASSBE/11

	Topic	ASSBE/11 score*	Notes
1	Tangible asset measurement (cost or revaluation), excluding leases	II	Both ASSBE/11 and tax law require cost measurement.
2	Depreciation (except leases)	IV (Some aspects look like Case I. However, the tax rules are more detailed than the accounting rules, so overall, there is a score of IV)	ASSBE/11: "Small enterprises shall calculate and draw depreciation according to the straight-line method. If it is necessary to accelerate the depreciation of fixed assets of small enterprises due to technological progress and other reasons, the double declining balance method and the sum of years method can be adopted. Small enterprises shall reasonably determine the useful life and estimated net residual value of fixed assets in accordance with the nature and use of fixed assets and taking into account the provisions of the tax law." Based on Tax Law: "Depreciation of fixed assets calculated by the straight-line method is allowed to be deducted. The enterprise shall reasonably determine the expected net residual value of the fixed assets according to the nature and use of the fixed assets. Once the estimated net residual value of fixed assets is determined, it shall not be changed. Unless otherwise stipulated by the financial and tax authorities under the State Council, the minimum period for calculating depreciation of fixed assets is as follows: (1) 20 years for houses and buildings; (2) 10 years for aircraft, trains, ships, machinery, machinery and other production equipment; (3) 5 years for appliances, tools and furniture related to production and operation activities; (4) 4 years for transportation tools other than aircraft, trains and shops and 3 years for electronic equipment. The fixed assets that can adopt the method of shortening the depreciation period or accelerating the depreciation include: (1) the fixed assets whose products are updated rapidly due to technological progress; (2) the fixed assets that are in the state of strong vibration and high corrosion all the year round. If the method of shortening the depreciation period is adopted, the minimum depreciation period shall not be less than 60% of the depreciation period; if the method of accelerating depreciation is adopted, the double declining balance method or the sum of years method may be adopted".

		In tax law also mentions that: "When calculating the taxable income, the depreciation of fixed assets calculated by the enterprise in accordance with the provisions shall be allowed to be deducted." No depreciation deduction is given for: (1) Fixed assets not put into use other than houses and buildings; (2) Fixed assets on operating leases; (3) Fixed assets leased on finance leases; (4) Fixed assets that have been fully depreciated and are still in use; (5) Fixed assets unrelated to business activities; (6) Land valued separately" Usually the useful life of PPE is decided by the companies. It cannot changed when determining the tax amount. Even if the company changes the useful life, the tax authority will still use the original useful life.
3 Impairment of tangible assets	II	Under accounting standards, the assets of a small enterprise shall be measured at cost and no provision for impairment of assets shall be made. The loss of fixed assets based on physical examination shall be included in non-operating expenses. In tax law: "When an enterprise increases or decreases the value of its assets during the period when it holds them, it shall not adjust the tax base of the assets, except that the profit and loss can be recognized according to the regulations of the financial and tax authorities under the State Council"
4 Lease classification	III†	Judgement based on the lease contract.
5 Grants and subsidies	I	Under accounting standards, these should be recorded as non-operating revenue. Based on tax law, they are regarded as revenue, some of them are not taxable.
6 Development costs	I	For accounting purposes, capitalisation if criteria are met. For tax purposes, deductions in excess of cost are allowed.
7 Inventory flow assumptions: FIFO or Weighted average	III†	Both ASSBE/11 and tax law allow FIFO or weighted average if specific identification is not used. The accounting choice will affect profit, and will generally be used for tax.

8	Inventory: use of net realisable value?	II	Under ASSBE/11: "The assets of a small enterprise shall be measured at cost and no provision for impairment of assets shall be made. The loss of inventory based on physical examination shall be included in non-operating expenses." That is, account is taken of damage when inventory is written off or disposed. Impairments are also not allowed for tax.
9	Revenue	II	The tax law and ASSBE/11 have specific regulations about what should be included in revenue. Although on some points they differ, for most companies accounting and tax revenue are the same.
10	Long-term contract revenue	III†	The accountants will rely on estimates from engineers, though there is scope for judgement. In tax law: "The realisation of income shall be recognised according to the completion progress or completed workload in the tax year." So, if the tax authority thinks the accountants provide reasonable estimates about completion progress, they will use numbers in financial report.
11	Wages, salaries	II	The tax law and ASSBE/11 have specific regulations about what should be included as staff costs. For most companies, the tax and accounting numbers are the same. However, there is a limit on the tax-deductibility of payments for trade union funds and staff education.
12	Interest capitalisation	II	ASSBE/11 and tax law both mention that interest should be included in the cost of PPE.
13	Foreign currency receivables/ payables	III	In ASSBE/11: "The exchange difference arising from the difference between the spot exchange rate on the balance sheet date and that at the time of initial recognition or the previous balance sheet date shall be included in the profits and losses of the current period". This part is taxable.
14	Amortisation/impairment of intangibles (other than R&D)	III†	Both ASSBE/11 and tax law have similar rules, e.g. requiring that amortisation should use lives not less than 10 years. The choice of life for accounting will affect tax.
15	Contingencies, provisions	III	In accounting standards, the provision will be recognised when spent.
16	Pension expenses	I	Under tax law, some pension expenses can be deducted and some cannot.

17 Policy changes, error correction	III	Small enterprises should adopt the prospective method to deal with the changes of accounting policies, accounting estimates and accounting errors. This affects current period income, and that is followed for tax purposes.
18 Fines, entertaining expenses	I	In ASSBE/11, fines and entertaining expenses are recognised as administration expense. In tax law: "The fine cannot be deducted. The entertainment expenses incurred by the enterprise related to production and operation activities shall be deducted according to 60% of the amount incurred, but the maximum amount shall not exceed 5% of the sales in the current year."
19 Financial asset measurement	III	Under ASSB/11, long-term equity investment should adopt the cost method. Tax law just mentions that the revenue from investment should be taxable.
20 Impairment of receivables	III	Under ASSBE/11, estimates of bad debts are not recognised. A loss is recorded when debts are written off. Tax follows this treatment.

Source: China scores prepared by the author. Note: * as explained in Table C.5.

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