Accounting Standards for Enterprises No. 2 - Long-term Equity Investments

Cai Kuai [2006] No.3

Chapter I General Provisions

Article 1In order to regulate the recognition and measurement of long-term equity investments, and disclosure of relevant information, these Standards are formulated in the light of the Accounting Standards for Enterprises - Basic Standards.

Article 2Other relevant accounting standards shall apply to such items as follows:

(1)The Accounting Standards for Enterprises No. 19 - Foreign Currency Translation shall apply to the translation of long term equity investments in foreign currencies; and

(2)The Accounting Standards for Enterprises No. 22 - Recognition and measurement of Financial Instruments shall apply to the long term investments which haven't been dealt with by the present standards..

Chapter II Initial Measurement

Article 3The initial cost of the long-term equity investment formed in the merger of an enterprise shall be ascertained in accordance with the following provisions:

(1)For the merger of enterprises under the same control, if the consideration of the merging enterprise is that it makes payment in cash, transfers non-cash assets or bear its debts, it shall, on the date of merger, regard the share of the book value of the owner's equity of the merged enterprise as the initial cost of the long-term equity investment.

The difference between the initial cost of the long-term equity investment and the payment in cash, non-cash assets transferred as well as the book value of the debts borne by the merging party shall offset against the capital reserve. If the capital reserve is insufficient to dilute, the retained earnings shall be adjusted.

If the consideration of the merging enterprise is that it issues equity securities, it shall, on the date of merger, regard the share of the book value of the owner's equity of the merged enterprise as the initial cost of the long-term equity investment.

The total face value of the stocks issued shall be regarded as the capital stock, while the difference between the initial cost of the long-term equity investment and total face value of the shares issued shall offset against the capital reserve. If the capital reserve is insufficient to dilute, the retained earnings shall be adjusted.

(2)For the merger under different control, the merging party shall, on the date of merger, regard the merger costs ascertained in accordance with the Accounting Standards for Enterprises No. 20 - Merger of Enterprises as the initial cost of the long-term equity investment.

Article 4Besides the long-term equity investments formed by the merger of enterprises, the initial cost of a long-term equity investment obtained by other means shall be ascertained in accordance with the provisions as follows:

(1)The initial cost of a long-term equity investment obtained by making payment in cash shall be the purchase cost which is actually paid.

The initial cost consists of the expenses directly relevant to the obtainment of the long-term equity investment, taxes and other necessary expenses.

(2)The initial cost of a long-term equity investment obtained on the basis of issuing equity securities shall be the fair value of the equity securities issued.

(3)The initial cost of a long-term equity investment of an investor shall be the value stipulated in the investment contract or agreement except the unfair value stipulated in the contract or agreement.

(4)The initial cost of a long-term investment obtained by the exchange of non-monetary assets shall be ascertained in accordance with the Accounting Standards for Enterprises No. 7 - Exchange of Non-monetary Assets.

(5)The initial cost of a long-term equity investment obtained by recombination of liabilities shall be ascertained in accordance with Accounting Standards for Enterprises No. 12 - Debt Restructuring.

Chapter III Subsequent Measurement

Article 5The following long-term equity investments shall, in accordance with Article 7 of these Standards, be measured by employing the cost method:

(1)A long-term equity investment of an investing enterprise that is able to control the invested enterprise.

The term "control" refers to the power to determine the financial and operating polices of an enterprise and obtain benefits from its operating activities of the enterprise.

If the investing enterprise can control an invested entity, the invested entity as its subsidiary company shall be included in the consolidation range of the consolidated financial statements.

For a long term equity investment on the subsidiary company of an investing enterprise, the investing enterprise shall accounted by employing the cost method as prescribed by these Standards, and shall make an adjustment by employing the equity method when it works out consolidated financial statements.

(2)A long-term equity investmentofinvestment of the investing enterprise that does not do joint control or does not have significant influences on the invested entity,andentity, and has no offer in the active market and its fair value cannot be reliably measured.

The term "joint control" refers to the control over an economic activity in accordance with the contracts and agreements, which does not exist unless the investing parties of the economic activity with one an assent on sharing the control power over the relevant important financial and operating decisions.

Where an investing enterprise and other parties do joint control over an invested entity, the invested entity shall be their joint enterprise.

The term "significant influences" refers to the power to participate in making decisions on the financial and operating policies of an enterprise, but not to control or do joint control together with other parties over the formulation of these policies.

Where an investing enterprise is able to have significant influences on an invested entity, the invested entity shall be its associated entity.

Article 6When ascertaining whether or not it is able to control or have significant influences on an invested entity, an enterprise shall take into consideration the invested enterprises' current convertible corporate bonds and current executable warrants held by the investing enterprise and other parties, as well as other potential factors concerning the voting rights.

Article 7The price of a long-term equity investment measured by employing the cost method shall be included at its initial investment cost.

If there are additional investments or disinvestments, the cost of the long-term equity investment shall be adjusted.

The dividends or profits declared to distribute by the invested entity shall be recognized as the current investment income.

The investment income recognized by the investing enterprise shall be limited to the amount received from the accumulative net profits that arise after the invested entity has accepted the investment. Where the amount of profits or cash dividends obtained by the investing entity exceeds the aforesaid amount, it shall be regarded as recovery of initial investment cost.

Article 8A long-term equity investment of the investing enterprise that does joint control or significant influences over the invested entity shall, in accordance with Articles 9 through 13 of these Standards, be measured by employing the equity method.

Article 9If the initial cost of a long-term equity investment is more than the investing enterprise' attributable share of the fair value of the invested entity's identifiable net assets for the investment, the initial cost of the long-term equity investment may not be adjusted.

If the initial cost of a long-term equity investment is less than the investing enterprise' attributable share of the fair value of the invested entity's identifiable net assets for the investment, the difference shall beincludedbe included in the current profits and losses and the cost of the long-term equity investment shall be adjusted simultaneously.

The fair value of the identifiable net assets of the invested entity shall be ascertained by referring to the relevant provisions of the Accounting Standards for Enterprises No. 20 - Merger of Enterprises.

Article 10After an investing enterprise obtains a long-term equity investment, it shall, in accordance with the attributable share of the net profits or losses of the invested entity, recognize the investment profits or losses and adjust the book value of the long-term equity investment.

The investing enterprise shall, in the light of the profits or cash dividends declared to distribute by the invested entity, calculate the proportion it shall obtain, and shall reduce the book value of the long-term equity investment correspondingly.

Article 11An investing enterprise shall recognize the net losses of the invested enterprise until the book value of the long-term equity investment and other long-term rights and interests which substantially form the net investment made to the invested entity are reduced to zero, unless the investing enterprise has the obligation to undertake extra losses.

If the invested entity realizes any net profits later, the investing enterprise shall, after the amount of its attributable share of profits offsets against its attributable share of the un-recognized losses, resume to recognize its attributable share of profits.

Article 12The investing enterprise shall, on the ground of the fair value of all identifiable assets of the invested entity when it obtains the investment, recognize the attributable share of the net

profits and losses of the invested entity after it adjusts the net profits of the invested entity.
If the accounting policies and accounting periods adopted by the invested entity are different from those adopted by the investing enterprise, an adjustment shall be made to the financial statements of the invested entity in accordance with the accounting policies and accounting periods of the investing enterprise and recognize the investment profits or losses.
Article 13Where any change is made to the owner's equity other than the net profits and losses of the invested entity, the book value of the long-term equity investment shall be adjusted and be included in the owner's equity.
Article 14For a long-term equity investment for which there is no offer in the active market and of which the fair value cannot be reliably measured, if the investing enterprise has not joint control or significant influence over the invested entity any more as a result of the decrease of investment or other reasons, the cost method shall be employed in the measurement, and the book value of the long-term equity investment employing the equity method shall be regarded as the initial investment cost to be measured by employing the cost method.
If an enterprise is able to do joint control or significant influence, which does not constitute control, over the invested entity as a result of additional investment or other reasons, the equity method shall be employed in the measurement, and the book value of the long-term equity investment measured by employing the cost method or the book value of investment ascertained in accordance with the Accounting Standards for Enterprises No. 22 - Recognition and Measurement of Financial Instruments shall be regarded as initial investment cost measured by employing the cost method.
Article 15The impairment of a long-term equity investment which is measured by employing the cost method as prescribed in these Standards, for which there is no offer in the active market and of which the fair value cannot be reliably measured, its impairment shall be disposed in accordance with the Accounting Standards for Enterprises No. 22 - Recognition and Measurement of Financial Instruments. The impairment of any other long-term equity investment measured in accordance with these Standards shall be disposed in accordance with the Accounting Standards for Enterprises No. 8 - Asset Impairment.
Article 16When disposing of a long-term equity investment, the difference between its book value and the actual purchase price shall be included in the current profits and losses.
If any change other than the net profits and losses of the invested entity occurs and is included in the owner's equity, the portion previously included in the owner's equity shall, when disposing of a long-term equity investment measured by employing the equity method, be transferred to the current profits and losses according to a certain proportion.

Chapter IV Disclosure

Article 17An investing enterprise shall, in the notes, disclose the information concerning long-term equity investments as follows:
(1)The name list of its subsidiary companies, joint ventures and associated enterprises, consisting of the names, registration places, and business nature, proportions of shares and proportions of voting rights of the investing enterprises;

(2)The main financial information of the joint ventures and associated enterprises, consisting of the aggregate amounts of assets, liabilities, incomes, expenses, etc;

(3)The information about the restriction of the invested entity' s capacity of transferring funds to the investing entity;

(4)The current period and accumulative amounts of unrecognized investment losses; and

(5)The contingent liabilities or the investments in the subsidiary companies, joint ventures and associated enterprises.