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Llinks Corporate Finance Bulletin
September 2008

Domestic Listed Companies to Implement New Internal Control Standards

By Grant Chen and Zhengyi Zhang

On 28 June 2008, the Basic Regulations for Enterprise Internal Control (**Basic Regulations**) was jointly issued by the Ministry of Finance, the China Securities Regulatory Commission, the National Audit Administration, the China Banking Regulatory Commission and the China Insurance Regulatory Commission. The Basic Regulations will take effect on 1 July 2009. Chinese listed companies are required to implement the Basic Regulations. In the meantime, private large and medium-sized Chinese companies are encouraged to adopt the Basic Regulations. According to the Basic Regulations, listed companies that implement these standards should conduct self-evaluations on the effectiveness of their internal control, disclose their annual self-evaluation reports, and appoint accounting firms qualified for securities and futures-related businesses for them to review the effectiveness of their internal control, if the companies deem it necessary.

The Basic Regulations consists of 7 chapters and 50 articles and has several significant aspects. It emphasizes that the internal control is a process carried out by the board of directors, the board of supervisors, management personnel and other staff. It also clarifies that this internal control aims to guarantee the legality of companies' management, security of assets, completeness and accuracy of financial statements and other relevant information, to raise the effectiveness of management and to promote their successful development strategies.

The Basic Regulations establishes an internal control structure that contains five factors. The first one is the foundation of internal control ——internal circumstance, which usually includes corporate governance, organizations, internal auditing, human resources, enterprise culture etc. The second factor is risk evaluation, which is a key when conducting internal control. The enterprises shall recognize and analyze the risks related to the internal control, and reasonably determine the countermeasures to prevent the risks. The third factor is control activity, which is to fortify control over the internal activities according

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to the result of the risk evaluation. Then the forth and fifth factors require the enterprise to set up both the information and communication systems as well as the internal control supervision mechanism in order to strengthen internal communication and reinforce internal supervision.

The Basic Regulations is a major milestone in the development of internal controls within Chinese companies. Implementation of the Basic Regulations will help ensure the reliability of the financial information of enterprises, reduce and prevent fraud of listed companies, and support the healthy development of the Chinese capital market. It has been declared that three detailed rules will be issued following the employment of the Basic Regulations.

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The article was first published in *ALB China Issue 5.8, 2008.*