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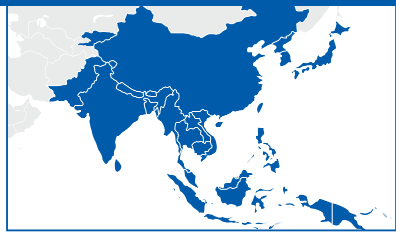

China Insights: Audit of Foreign Invested Enterprises

Background

Foreign Invested Enterprises (FIE) refer to enterprises founded in China by foreign enterprises, economic organisations or individuals, the registered capital of which is subscribed and contributed by a foreign investor(s).

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LehmanBrown International Accountants is a member of MGI Asia with office locations in Beijing, Guangzhou, Hong Kong, Macau, Shanghai, Shenzhen and Tianjin, China. Dickson is a Senior Partner at the firm and also North Asia Circle Leader for MGI in Asia. Dickson has over 24 years China accounting and financial experience and the firm has been a member of MGI Worldwide for 10 years. For more information go to www.lehmanbrown.com

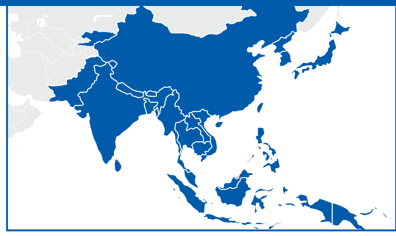
According to the People's Republic of China ("PRC") Company law and relevant legislations, all Foreign Invested Enterprises ("FIEs") such as Wholly Foreign Owned Enterprises ("WFOEs") and Joint Ventures ("JVs") are required to prepare their annual financial statements, including balance sheets, income statements and cash flow statements for their annual PRC statutory audit to the Administration of Industry and Commerce ("AIC"). Representative Offices ("ROs") are also subject to annual statutory audit. An annual statutory audit can only be performed by a firm of Certified Public Accountants ("CPA Firm") registered in the People's Republic of China. FIEs can only distribute and repatriate their profits or dividends back to their home country after completion of their annual statutory audits and settlement of all relevant tax liabilities. There are some exceptions for limited transaction companies in the Free Trade Zones where an exemption can granted by the authorities.

The Process

FIEs are governed by the Chinese Accounting Standards for Business Enterprises (ASBEs) and the Accounting Regulations for Business Enterprises (ARBEs), collectively referred to as PRC GAAP, and there are no basic differences between standards for domestic and foreign enterprises. FIEs, including their legally responsible person, shall take full responsibility for the truthfulness, legitimacy and completeness of the financial statements.

When performing the statutory audit, the CPA shall observe the Chinese Independent Auditing Standards (CIAS) promulgated by the Chinese Institute of Certified Public Accountants (CICPA). The objective of a statutory audit is for the CPA to express an opinion on whether the financial statements fairly present, in all material respects, the company's financial position as at year-end, the results of its operations and its cash flows for the year, in accordance with the requirements of both ASBEs and ARBEs.

In China, the accounting year is the calendar year, i.e. 1st January to 31st December. After completing the annual statutory audit, the annual filing process, which is also termed as " Joint Annual Inspection" is required. This process involves the submission of a statutory audit report, including but not limited to, the audited financial statements, tax examination report and foreign exchange examination report, to the various government authorities, as required under Chinese legislation. The annual filing process is required for the purpose of renewing business licenses and relevant certificates.



The filing deadlines start from May of the following year. For example, annual corporation income tax filing, (which uses audited financial figures for the financial year ending 31st December of the preceding year as the bases before making any tax adjustments), is due by 31st May of the following year. The statutory filing deadline is indicated in an annual announcement issued by the relevant government authorities, which is normally announced after the year-end. This means that performing the statutory audit is required before the statutory filing deadline.

Below are the government annual inspections which would require the audit report or an extract of financial figures from the audit report.

- Annual CIT filing – deadline by 31st May
- AIC Enterprise Credit Information Publicity – deadline by 30th June
- Customs inspection – deadline by 30th June
- Joint Annual Report – deadline by 31th August
- State Administration for Foreign Exchange (SAFE) – deadline by 30th September

*All dates quoted in this article are accurate as of June 2016, and may be subject to change.

The Value

For the company, be it for the business, tax or internal control purposes, an audit can be very valuable and beneficial. By the audit process, the auditors enhance the value of the financial statements, including

Fairness of Financial Statements

Giving an opinion on the fairness of the financial statements is generally regarded as the main focus of the auditors. An audit serves as a "double-check" on what management believes is correct. The auditors provide unbiased opinion on financial statements and accounting treatment.

Ability of Going Concerns

The auditor will make an assessment of the company's ability as a going concern. When events or conditions have been identified which may cast significant doubt, the auditor will review management's plans for future action based on its going concern assessment and gather sufficient and appropriate audit evidences to confirm or dispel whether or not a material uncertainty exists through carrying out procedures considered necessary.

Tax Risk and Advice

The auditor will analyse what the tax risks are and give appropriate advices to the company in order to avoid or minimize tax risks through understanding of the nature of the company's business and the tax treatment adopted by the company. Alternatively, the auditor could be in a position to provide advice on tax planning through an in-depth understanding of the company's business and the various tax laws and regulations issued by the authorities.

Internal Controls

The company should maintain a sound system of internal control to safeguard both the shareholder's investment and the company's assets. In the process of audit, the auditor will conduct a review of the effectiveness of the internal control systems of financial, operational and risk management. If there are internal control deficiencies, the auditor shall communicate directly with the management in written form, such as a management letter, and provide some practical recommendations as to how to address the issues identified.

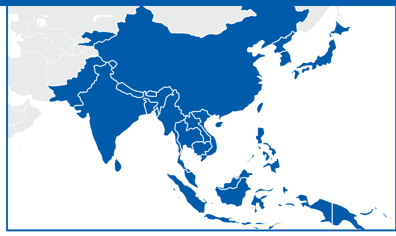
Fraud

Fraud refers to intentional acts resulting in (quantitative and/or qualitative) misstatement in financial statements. Fraud, as it relates to financial statements, may be categorized into two types:

- Misstatements arising from fraudulent financial reporting to mislead/deceive users of financial statements; and
- Misstatements in financial statements arising from misappropriation of assets.

When auditors suspect that there are misstatements in the financial statements due to fraud, they would perform necessary and sufficient auditing procedures to confirm or dispel their suspicion about the existence of misstatements.

The above are matters of corporate governance as well as reporting and are all concerns for the auditor. If the auditor obtains evidence to support a view that fraud may exist or evidence confirming that a significant misstatement or operation risk does exist, he would communicate the misstatement to the appropriate level of management and to the director, if applicable. By promptly communicating these issues to management, the auditor facilitates adjustments and appropriate changes so that the financial statements will be able to meet the objective of truly and fairly reflect the company's financial position and operating results. The auditors should maintain an attitude of professional scepticism at all times. Excellent auditors can always identify problems in time and provide practical recommendations to the company to avoid risks. Consequently, auditing serves a valuable function other than helping the company in fulfilling a statutory requirement in China.



How LehmanBrown can support you

LehmanBrown is highly experienced and able to handle all aspects of PRC statutory audit report compliance and filing including:

- Conduct a statutory audit in accordance to Chinese Auditing Standards over the financial statements prepared under PRC GAAP.
- Prepare CIT computation, including issuing of tax report, for annual CIT filing purpose.
- Perform on-line submission using the audited financial figures to SAFE and SAIC.

In addition to issuing of the audit report in line with Chinese regulations, LehmanBrown can also deliver additional reports in accordance with other international accounting standards, such as IFRS, US GAAP or the German HGB as well as the additional management letter as required.