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China WFOE Maintenance and Compliance Guide (12)

Statutory Audit of the Financial Statements of WFOE in China

1. Statutory Audit in China

According to the Company Law of the PRC, a one-person limited liability company shall prepare a financial report by the end of every fiscal year and have the report audited by a certified public accounting firm registered in China. The term "one-person limited liability company" refers to a limited liability company with only one natural person shareholder or legal person shareholder. A non-one-person limited liability company, that is, a company with two or more shareholders, is exempt from audit.

Annual statutory audits are required for wholly foreign owned enterprises (WFOEs) with only one shareholder in accordance with the foregoing provisions.

2. What are the key areas of annual audits?

When a CPA performs an annual audit, in deciding on the appropriate audit procedures for income statement and balance sheet accounts, the auditor should assess the risk of error and fraud in those accounts. What are the key areas they are most concerned about? We can divide this into three areas:

(1) How to present profit?

The sales figure is a critical part of a review. Usually the following issues are the control objectives: Sales cut-off check ensures that all valid sales comply with revenue recognition criteria, recorded and properly billed; customer contracts are properly setup, approved, invoiced, priced and executed; pricing is accurate, updated and monitored by management; and gross margin is appropriate on all sales transactions, if not there must be legitimate reasons.

(2) How to present cost?

Cost of sales/revenues should represent all transactions for products sold or services provided during the year and be properly recorded. This requires a thorough costing system review.

(3) What are the revenue & cost accruals?

Expense / cost is not recognized on a cash basis, but on accrual basis. Subsidiary ledger reviewal and substantive analysis procedures are often employed to check if revenue and cost are properly accrued at the year end.

These concerns are based on one important accounting principle - prudence. Recently, there is a developing trend of FIEs, instead of recording profits, reporting a loss. With this growing, the tax bureau and government are devoting more effort in auditing FIEs. As a result, if a company reports profit margin and tax burden rate below the industry average or is in deficit in consecutive years, the auditors will monitor the possibility of any potential attempt to conceal profit to evade taxes and will evaluate transfer pricing issues within related party transactions.

3. How to prepare for the annual audit?

Conducting a sound internal review prior to annual audit is a good idea. Make sure your bank reconciliation report is completed for bank accounts, that petty cash has no major discrepancies, and conduct a complete check of accounts receivables and accounts payables. An overall inventory stock take at the year-end is also a must for manufacturing entities.

The company should review its internal control system and financial policies, such as depreciation method, costing system, pricing policy, not only for the purpose of annual audit, but also for good future internal management.

Please have all these following available for the auditor before they arrive: Accounting Vouchers, Account Books, Warehouse Records, Financial Statements, Tax Filing Records, Bank Statements, Cash Count Statement, Fixed Assets List, Inventory Sheet, Invoices, Contracts, Vendor Statements, and other relating document and reports. If you can check some of these items yourselves prior to audit, you may well pre-identify some problems themselves.

KAIZEN Group is equipped with experienced and highly qualified professional consultants and is therefore well positioned to provide professional advices and services in respect of the formation and registration of company, application for various business licences and permits, company compliance, tax planning, audit and accounting in China. Please call and talk to our professional consultants for details.

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SERVICES SCOPE

CORPORATE SERVICE

Company Formation & Registration
Lease assist
Company Secretary
Merge & Acquisition
Dis-registration & Dissolution
Cancellation of Liquidation

ACCOUNTING & AUDITING

Financial Advisory
Due Diligence
Company Secretary
Accounting & Book-keeping
Statutory Audit
Special Audit

TAXATION

Tax Advisory
Tax Planning
Tax Reporting
Tax Compliance
Tax Audit
Transfer Pricing

INTELLECTUAL PROPERTY

Trademark Registration
Trademark Infringement
Trademark Watch
Design Registration
Patent Registration

PERSONNEL

Staff Hiring
Labor Displacement
Payroll Processing
Human Resource
Legal Advisory

VISA

Work Visa
Business Visa
Entrepreneurship Pass
Investment Immigrant
Skilled Immigrants

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