

Warning Signals: Fraud

There has been a global wind of change concerning compliance and cross-border reporting regulations. Fraud and corruption are costing the global economy an estimated USD 1.5 trillion a year. Especially in China, this topic is coming to the forefront, as the government has launched a number of high-profile anti-corruption cases in recent years. Various anti-fraud surveys estimate that companies may be losing as much as 7% of their turnover as a result of corruption, with only a small percentage detected and recovered every year.

With the Chinese government seriously ramping up its investigations, it is a critical time for foreign companies operating in China to ensure compliance. Fraud can happen at all levels within a company and is not limited to a particular sector or even country. This is why many Fiducia clients hire us to analyse their current procedures to ensure the compliance of their China entities with the relevant laws and regulations.

While there is no fail-proof way to guard your business from corruption, we have come across a number of common reasons in our investigations. Below we share a few areas you can already keep an eye on to assess if you need to investigate further.

Management

An unexpectedly high percentage of fraud occurs at senior management level. In these cases there is often a lack of clear reporting lines and review mechanisms. Sometimes bonus schemes can be too ambitious, being linked directly to financial results, increasing the incentive to engage in corrupt practices. In addition, often there are no proper training systems in place when it comes to

professionalism in key accounting principles. We can help you devise a clear management control structure, covering responsibilities, authorities, delegation, and supervision.

Employees

Since awareness for anti-corruption is fairly new to China, often times the commitment of staff from all levels is still limited. This is why it is essential that companies have adequate recruitment and screening processes. Low salary levels, coupled with general dissatisfaction can have negative consequences, especially if the employee has access to desirable assets. We recommend revisiting your employment contracts and employee handbook, as well as your employer branding strategy, to ensure a healthy team with clear supervision.

Processes

Having clear internal control processes in place is a must-have in this day and age. Too often do we come across poor documentation practices and a lack of segregation of duties and independent checking mechanisms of key transactions. Frequently physical assets are not classified and properly accounted for. Moreover, access to critical IT systems is not monitored, allowing for fraudulent activities. We advise to take stock of your assets and set up transparent and clear reporting and documentation processes.

Fiducia carries out internal audits of your operations and can help you to structure your risk management by providing hand-on solutions. Email us at contact@fiducia-china.com for more information. ☎

The Fiducia Health Check

Every company's situation is unique. Therefore, every Fiducia Health Check is tailored to your individual requirements. Our on-site experts can look at the following areas in your China operations to ensure compliance and transparency:

- ▶ **Labour Contracts:** compliant compensation packages, social security payments
- ▶ **Operations:** SOP, IT, benchmarking, cost efficiency and effectiveness
- ▶ **Finance:** financial due diligence, M&A, management reporting, analytical review
- ▶ **Revenue Cycle:** Income verification to pricing, billing, and collections
- ▶ **Tax:** fapiao management, tax returns, VAT refunds, transfer pricing, tax documentation requirements, tax residency, exchange of information
- ▶ **Fixed & Current Assets Management:** inventory, cash, cheques, company chops, bank security devices, statutory documents
- ▶ **Supply Chain:** inventory and procurement, cost control, and payments
- ▶ **Risk Management:** regulatory and compliance risk assessment
- ▶ **Fraud Detection:** internal control system, regular review by external / internal auditors

Fiducia Dashboard



The Fiducia ERP team can customise a dashboard for your unique needs to help you:

- ▶ monitor your business activities in real time across all departments
- ▶ generate customised and regular reports with one click
- ▶ identify accounting warning signals and respond immediately
- ▶ establish proper financial compliance and reporting procedures
- ▶ align your accounting and controlling practices across borders

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With a number of new regulations in the pipeline, many Fiducia clients have seized the opportunity to launch a company **Health Check** to review their procedures, optimise costs, and minimise risk for their business.

APK 2016



The Asia-Pacific Conference of German Business or APK for short, is the flagship event in the region for business leaders, executives and government representatives to discuss and promote economic relations between Germany and Asia. The conference has evolved into the largest German networking event in the region, regularly attracting hundreds of business and political leaders from both regions to meet and greet in this occasion.

Fiducia is a proud Gold Sponsor of this year's Asia Pacific Conference of German Business in Hong Kong.

<http://www.asiapacificconference.com/>

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Diagnosing Unhealthy Accounting

In an effort to simplify and consolidate existing accounting regulations, the Chinese government has recently implemented a number of changes and upgrades, which will affect all companies operating in China: for one, the new Five-in-One permit system will come into effect on 1 October 2016, merging the business license, tax-, statistics- and social insurance registration certificates, and the certificate of organization code into one permit under one number. In addition, China's top legislature adopted a new asset appraisal law – the first in nearly 30 years – which will go live in December 2016 to provide more in depth regulation of the industry. Lastly, and most importantly, China is constantly upgrading its accounting regulations to be in line with international accounting best practices, most notably manifested in the BEPS implementation. These are just the most recent samples of accounting changes that the country has undergone since its first major overhaul ten years ago.

The positive result of this is that China's business system is deeply reforming, promoting investment, innovation, and even entrepreneurship. It also gives many existing companies in China the chance to review their accounting, reporting, and compliance practices, which may now be out of date. With a number of new regulations in the pipeline, many Fiducia clients have seized the opportunity to launch a company Health Check to review their procedures, optimise costs, and minimise risk for their business. Below we highlight a few cases where a Fiducia Health Check successfully revealed accounting shortcomings and discrepancies that posed potential compliance risk and even led to substantial future cost savings for the clients.

Case 1: VAT Loss

A client noticed irregularities in their VAT declaration and hired Fiducia to perform a Health Check on their current tax reporting processes. During the investigation, we found that the company had not been declaring its VAT correctly. More importantly, they

had missed the deadline for declaring their VAT-input fapiaos! Even though there was a hefty fee of over RMB 50,000 associated with this, our experienced accountants were able to salvage the situation: because the company had paid excess VAT, the lost VAT-input could be offset and the client did not lose any money in the end. In addition, our experienced accountants put mechanisms in place to ensure that no further deadlines would be missed by the accounting team.

Case 2: Stock Taking

After an auditor in this client's HQ noticed some discrepancies in the company's China stock taking and reporting, Fiducia performed an inventory and fixed asset health check at a client's warehouse in South China. We discovered a large amount of obsolete inventory and generally poor stock taking habits by the local team. After a thorough clean-up, the client divided its assets, separated the outdated stock and as a result, was able to report the real value of the inventory back to HQ. In addition, Fiducia conducted an on-site training for the warehouse team to avoid this situation in the future.

Case 3: Internal Control

The CFO of this German company hired Fiducia to perform a Health Check on their China WFOE to ensure international alignment and local compliance. We structured the project in three phases, with close communication along every step. Phase 1 entailed detailed interviews with all key personnel to gain an understanding of the client's internal control practices, including reporting lines and business structure, and identify red flags and risks. Based on this, as well as independent research on best practices, our team made strategic recommendations for fraud precautions and improvements in phase 2. In the final phase, Fiducia assisted the client to realise these structural changes and setup the new internal control policy. As a result, the German HQ was able to adjust the company strategy in China to avoid compliance risk.

If you are interested in the Fiducia Health Check, please email us at contact@fiducia-china.com to speak to one of our consultants.

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