China overhauls foreign company annual inspections

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Regulators in China have revised a requirement that foreign-invested enterprises (FIEs) undergo a joint annual inspection, in favour of an online report procedure.

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China's five regulators jointly changed a requirement that FIEs submit to an annual inspection to online-based annual reporting, a move to streamline the audit process, on April 18.

"This is a welcome regulatory shift and we expect the administration of FIEs to become easier over time, with fewer filings, less meetings with inspectors, and more transparency," said Rocky Lee (pictured), head of greater China corporate practice at Cadwalader, Wickersham, & Taft, based in Beijing.

For more than 10 years, FIEs have had to undergo a joint annual inspection – akin to an audit – by the Ministry of Commerce, the State Administration for Industry and Commerce, the General Administration of Customs, the State Administration of Foreign Exchange, the State Administration of Taxation, and local tax authorities.

But under the new annual online report procedure, FIEs will only need to submit their annual reports via an online system. Enterprises are encouraged to use a qualified accounting firm to prepare and submit the annual reports on their behalf. The 2013 report needs to be submitted within the period April 21, 2014 to June 30, 2014.

The move from inspection to reporting is intended to encourage foreign corporates to perform their own annual self-assessments and to be audited both internally and externally, said Yin Toa Lee, a partner in EY's financial accounting advisory services, based in Hong Kong.

The release announcing the change was jointly made by China's five ministry, or deputy-ministry level regulators, the Ministry of Commerce, the Ministry of Finance, the State Administration of Taxation, the State Administration of Foreign Exchange, and the National Bureau of Statistics.

Such coordination between bureaucracies is uncommon and may be evidence that the new process is part of a higher-level initiative.

"When a joint regulation is promulgated it is often suggested that a higher authority in government mandated such change of law," said Cadwalader 's Lee.

The previous inspection process has been an especially important aspect of Chinese business to get right, as an FIE can only repatriate profits to foreign investors if all applicable taxes are in order. Approval is so critical that Chinese legal practitioners say it has attracted corruption in the past.

"For example, if the company name in the invoice [during an annual inspection] was written incorrectly, the corporates had to change it, and sometimes employees of FIEs were asked to give some gifts to smooth the process, a practice of corruption that is not liked," said a legal practitioner familiar with the inspection process.

Although corporates will now undergo a less intrusive annual reporting procedure, the consequences of getting the process wrong will still be dire, according to experts.

Reporting fake information, or failing to meet annual report deadlines may result in being blacklisted. The information of legal representative of corporates with false information in their reports will be sent to government departments of public security, finance, customs, taxation, and others. Corporates failing to report for more than three years will be included in the "blacklist" of companies with serious violations.

"Corporate CFOs need to be continuously maintaining effective internal controls with not only the adequate capital level, but also robust documentation for their capital review policies and procedures," EY's Lee said. The new online reporting practice will only apply to FIEs, a distinction that some accountants deem to be of dubious legal standing.

"There is a company law in place which is applicable to all companies," said Russell Brown, managing director of Lehman Brown, a China-based accounting firm. "Accounting and filing requirements should also be applicable equally to all companies. There should not be an FIE regulation."

But experts say the same audit and inspection level for foreign and domestic companies is on its way.

"Pursuant to the World Trade Organisation commitments, China will gradually begin to remove the distinction of 'foreign' versus 'domestic' enterprises and this [FIE annual reporting rule] is likely a first step in such direction," said Cadwalader's Lee.

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