



Why Due Diligence in China!

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Why Due Diligence in China!

In Western countries as in China, it is imperative to carry out sufficient due diligence on whom you are going to be doing business with, to reduce the risks. Peeling back the layers though in some countries might be like the skin on an apple, peel one layer and you have found the information that you are looking for. In China, while the access to information has improved, you are still really dealing with an onion, with many layers.

Does your company invest or donate its money? Sensible companies or individuals would no more invest in a company without due diligence than give a blank corporate check to the first person with an extraordinary business proposition, or would they?

China is continuing to grow and is changing rapidly, while the business environment and ease of doing business have been steadily improving. As of April 1, 2019, a great VAT tax reform was implemented, seeing a reduction for Individual Income Tax, aiming to combat the rising costs in China. Meanwhile, in 2017, the State Council issued two “Circular on Several Measures to Promote Further Openness and the Active Utilisation of Foreign Investment” policies to cut down the government’s administrative procedures and improve the regulatory environment for foreign businesses in China.

Further benefits come from the new Foreign Investor Law (FIL), which is intended to develop a level playing field for foreign investors. The law aims to eliminate the theft of Intellectual Properties (IP) in Joint Ventures (JV) and prohibit government officials from forcing companies to transfer technology as well as making such actions illegal in China. To make China more accessible, the government released a shortened Negative Lists allowing for opportunities in more sectors for foreign investments. Possible new industries can include the agricultural, mining, manufacturing, and services, and enable Wholly Foreign Owned Enterprises (WFOE) to engage in more sectors.

However, underneath the positive changes, many problems are still troubling the Chinese market. For example, there are cases of inconsistent regulatory interpretations or implementational guidelines, unclear laws and enforcement, and ever-growing risks regarding regulatory non-compliance for foreign businesses. Furthermore, foreign companies in recent surveys in China feel unfairly targeted when undergoing tax audits and work permit reviews, compared to their local competitors. To combat these issues, international companies and investors through political advocacy are pushing for the development of a level playing field and improved intellectual property security.

Political pressure and advocacy applied externally and internally in China can be seen with the EU and EU Chamber of Commerce in China. As of 2016, The European Commission adopted a new strategy on China changing the EU’s relationship with China for the next five years proposing that the EU should promote reciprocity, a level playing field and fair competition across all areas of cooperation. While the EUCCC applies pressure from within as seen in their yearly Position Paper.

“We do not question the willingness of China’s top leadership to continue to open up and reform, but a new approach is needed to implement change. It is not sufficient that the top leadership is committed to reform and opening-all levels of government need to embrace this direction. After all, many of the problems faced by international companies are not necessarily an expression of state policy, but instead result from poor regulations designed by lower-level officials that are inconsistently enforced. While the European Chamber recognises such difficulties, our member companies cannot wait indefinitely for these much-needed reforms.” *Mats Harborn, President of the EUCCC, Executive Position Paper 2018/2019*

So, is investing in China, the world’s biggest market, something to be avoided?

Not at all, as long as you do your due diligence because taking a calculated risk is what business is all about. Note the word “calculated” is used advisedly, as business decisions inherently should be based on sound information. Any experts can brush off a case of a failed joint ventures or business as a bad investment. However, does anyone look at the quality of due diligence was done before entering in such an endeavour? The truth is, that it is unlikely, as the mother company's board will rationalise everything into corporate history, citing the Chinese as being protectionist. Perhaps they should mention them as the smarter partner, or that they did not do their homework.

What exactly does due diligence take into consideration?

Due diligence is much broader in scope than is generally perceived. Regardless of which country you are doing business in making a substantial investment in getting to know the prospective partner or the proposed market, is not money that should be begrudged. It is imperative to seek answers to vital questions in areas such as:

Management. Who are the management team? Have they worked together before and are their ideas compatible? What experience does each member bring to the table, and is it relevant? What is the focus of each member? Is the team complete?

Legal Issues. Is the investment in the country legal? Are there any restrictions imposed on that particular industry within the country? Is the company operating within the scope of the business (i.e. is the company acting ultra vires)? Have the local partner’s fixed assets, to be used as a capital injection into the new company, actually been pledged to the bank? Have the land rights been granted the appropriate land certificate? Are there any restrictions on the company’s land-use rights? Who owns the IP, or will own the IP in the future, and has any IP being brought into China been registered already, and can it be registered?

Concept. What is the overall timetable for the project? Will the product have a competitive advantage in that specific market? Are there Intellectual Property or Patent and Trade Mark issues? What is the local business regulatory issues, and does the plan allow enough time for these to be resolved?

Expanding on the arguments of Concept, considering China’s enormous economic growth and numerous reforms that occurred in the past decades, it is recommended for any would-be investor or business to maintain some level of due diligence. Like in any country the Rule-of-Law must be adhered to where ever you are operating in. However, unlike most countries, when reforms are finally enforced in China, the changes come swiftly often catching unsuspecting foreign business and investors by surprise. Staying on top of Government and local regulations is a constant necessity when operating anywhere in the world, in some cases, more so in China.

Given all of that, time must be factored in as well. Westerners used to the speed of business in developed nations are often frustrated by the multiplicity and the seemingly overly bureaucratic state of government departments. With proper due diligence, a project can set realistic timeframes reducing such frustrations from occurring in the first place.

Market. What about those cash flow and production projections? What data are they based upon? What are the estimates of the needs for the company's products or services? What market research has been done, and has it been analysed? What are the competitive advantages of the company's products/services in the Chinese market? What are the future marketing strategies? What is the pricing strategy? What about the competition?

Capital requirements. How much funding will be required presently, and into the future, and how will the financing be structured? Will additional funding be needed and, if so, when, at what stage in the project and from who?

Financial statements. It is essential to have three to five years projections, and for established companies, historical records going back for the same period. It is also imperative to understand the financial position of the Chinese partner, including whether the statements are presented in a "true and fair" manner. Similarly, are they in accordance with Chinese Accounting Standards (which is very close to IFRS)? Or, are there differences between management reporting and local books, and can these be explained.

Investigate. Last, but not least, investigate your proposed partner, using an investigator who can check through different channels. This is in addition to due diligence on the proposed joint venture partner and its owners.

So how do companies sort out this Gordian Knot?

Firstly, by getting the right advisors. With China's complex accounting system, rapidly changing legal and tax system and bureaucratic controls, seeking sound professional advice is paramount in setting up any China operation.

Secondly, by conducting due diligence. The key lesson learned is that in China, especially, it is imperative that an in-depth "Complete Business Due Diligence" be done before any firm begins in the China market.

Otherwise, it could end in tears!

Any enquiries, please contact LehmanBrown by enquiries@lehmanbrown.com

LehmanBrown International Accountants is a licensed China-focused accounting, taxation and business advisory firm, operating dedicated offices in Beijing, Tianjin, Shanghai, Shenzhen, Guangzhou, Hong Kong and Macau, and with an extensive affiliate network throughout China and in over 100 countries worldwide.



About Us

Founded in 2001, LehmanBrown is a licensed China-focused accounting, taxation and business advisory firm, operating in Beijing, Shanghai, Hong Kong, Macau, Shenzhen, Guangzhou and Tianjin. Our firm also manages an extensive affiliate network, providing service throughout China and reach across the globe.

Combining years of international expertise with practical Chinese experience and knowledge, LehmanBrown offers expert advice and support to both local and international clients. Within the mid-tier, we are regarded as a market leader and our clients enjoy access to a combination of senior and experienced counsellors from both China and abroad.

At LehmanBrown we recognise that you are unique, that you have unique requirements and we are committed to providing individually tailored financial solutions. LehmanBrown is dedicated to providing personalised service by working closely with our clients to understand your individual business needs. This enables us to offer the most up-to-date and expert advice.

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综合多年的国际经验和对中国市场的深刻理解和实践体验, 我们向广大国内外的客户提供高质量的专业服务和意见帮助。在雷博国际会计的服务过程中, 我们作为市场中的佼佼者, 您将得到来自中国本土以及其它国家的高级资深专家热忱的咨询帮助。

我们深刻认识到每一位客户都是独一无二的, 并都有其独特的业务需求。雷博国际会计承诺将根据客户的不同业务需求, 为客户提供个性化的财务解决方案。我们的专业人员将密切与您合作, 以充分了解您独特的业务需求, 从而提供满足您所需要的高时效、高质量的专业服务。

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[China Statutory Audit](#)

US GAAP Audit

IFRS Audit

Hong Kong Statutory Audit

[Internal Audit](#)

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Forensic Accounting

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Royalty Audit

Capital Verification Audit

Valuation Services

[Corporate Valuation](#)

Damage Assessment Valuation Intellectual

Property Valuation Asset Valuation

Special Purposes Valuation

Corporate Finance

Debt Restructuring

Acquisition, Disposal & Financing

Mergers & Acquisitions

Transaction Advisory

M&A Divesture

M&A Integration

Financial Due Diligence

Business Services

Company Registration & Maintenance

Cash Flow Management

Chop Custodian Services

Market Entry Advisory

Updating Company Certificates

Annual Inspection & Reporting

Company Secretarial Services

Company Ownership Transferring/Corporate

Restructuring Background/Credit Checking

Company Deregistration & Bankruptcy

HR Support Services

China Visa Services for Expatriates

Social Welfare Structures

Outsourcing Services

Accounting & Bookkeeping

Budgeting & Forecasting Financial Statement

Preparation Head Office Reporting

Financial Management

Interim Financial Management Finance

Manager Function

CFO Function

Treasury Management

Set-up of Bank Account

Payroll Services

Payroll Processing Setup

Expatriate Employees

Local Employees

Secondment & Temping Service

Taxation Services

Individual Tax Planning (IIT)

Tax Immigration & Investment Review

US & Overseas Personal Income Tax Planning

& Filing IIT Tax Payment Facilitation

Application for Individual Income Tax Refund

Expatriate Staff Individual Income Tax Staff

Filing Local Staff Individual Income Tax

Company Taxation (CIT)

[Tax Consulting](#)

Corporate Tax Planning

Business Restructuring

Value Chain Review

Onshore / Offshore Investment

Transfer Pricing

[Tax Compliance](#)

Tax Due Diligence

Tax Deregistration

Negotiation of Tax Penalties

Tax Refund Application

Tax Representatives for Tax Audit

VAT & Customs Duty Clearance

PRC Tax Receipt Verification

VAT Application

VAT & Sales Tax Filing

Corporate Income Tax Reporting

Specialist Accounting & Risk Management

Internal Controls

Systems

Risk Management

Sarbanes - Oxley (SOX 404)

GAAP, SEC & IFRS Compliance

[US GAAP](#)

US GAAP Financial Statement Preparation

US GAAP Conversion

[Other GAAP](#)

GAAP Conversion

Public Company Compliance

Financial Statement Preparation

[IFRS](#)

IFRS Accounting Repackaging

IFRS Financial Statement Preparation

IFRS Public Company Compliance

[SEC](#)

SEC Public Company Compliance

Legal Services

Legal Advisory

[Labour Legal Advisory](#)

Workforce Downsizing Advisory

Labour Tribunal Assistance & Advisory

Labour Law Review & Audits

Review & Preparation of Employment Contracts

[Corporate Legal Advisory](#)

Legal Due Diligence

Corporate Restructuring Advisory

Review & Preparation of Articles of Association (AoA)

Review & Preparation of JV Contracts

Review & Preparation of Repatriation Agreements

[Other Legal Services](#)

Dispute Mediation & Advisory

Trademark & Intellectual Property Advisory

Debt Collection Assistance

Litigation Support

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For further information about how we can add value and support your individual or business needs, please contact us.

如需为个人或企业获取更多的增值服务及业务协助信息，请与我们联系。

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