

CHINA FOCUS

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Is Your Business Healthy?

Since Fiducia's inception almost 35 years ago, we have advocated clean business practices for our own business and our clients alike. With the Chinese government's recent efforts to strengthen reporting transparency, compliance is an increasingly important topic for international companies operating in China. Thus, now is a good time to look at your commercial structure, accounting

practices, and team set-up to assess if your business is healthy and operating efficiently. In this China Focus, we explain some best practice solutions we employ with our clients, which can help you achieve operational and accounting excellence and avoid fraud, to ensure that your China business is running smoothly.



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Cross-Border Accounting Done Right!

As China is becoming increasingly stringent in their accounting regulations, many foreign companies must invest time and effort into upgrading their reporting practices. China Focus interviews Jürgen Hund, CFO of MEIKO Group, on how the company bridges the gap in their accounting between the headquarters in Germany and their organisation in China.

What is MEIKO's current accounting set-up in China?

MEIKO has been active in China for over 15 years. We have a complete production set-up in Zhongshan and almost 200 people, with an own finance department that works closely with our HQ in Offenburg but is still quite independent. Our controlling activities originate mostly from our HQ, by scheduling regular meetings with the local teams to identify any problems or special cases. Here, all teams from sales to service are represented and we address any unresolved questions or red flag.

What are typical accounting mistakes you have come across in China?

The biggest mistake you can make is ignoring local accounting practices and regulations. Even if you require a unified, global accounting reporting format for HQ at the end of the day, it may not be relevant to your company abroad. For example, if you apply German accounting practices in China, you probably won't receive accurate or even relevant

results. The first step is to consider what you need to show legally and on a local level; then you can take this information and adapt it for your HQ – not the other way around.

A second mistake many make is jumping the gun and entering the market before fully understanding what the local requirements are. In our case, MEIKO's operations in China are much more comprehensive than in other countries: from production to sales and after-sales, the entire spectrum of activities is represented. Only in the USA and in Offenburg do we have the same kind of set-up, making China a challenging market for us. We made sure we thoroughly understood what was required before we opened our doors, or else this can lead to big problems later on. It pays to hire a consultant, such as Fiducia, with experience in the market, to help you with your strategy.

What role can technology play to put proper operational procedures in place?

In this day and age, technology can help you substantially in making your operations more efficient, especially across borders. At MEIKO, we are currently in the process of implementing a unified ERP software on a global basis in order to have the same standards everywhere. Due to the size of our operations in China and the fast pace of the market, it is critical that we have easy access to our production activities there. Most importantly, this minimises the amount of manual input required from us, making our processes much smoother and better integrated. Our technological procedures

must be identical regardless of location, from consecutive project numbers to consistent labelling.

How do you manage the different accounting standards in China vs HQ?

MEIKO is fully owned by a foundation and we are not publicly listed, therefore we do not have accounting obligations that we must follow. Nonetheless, we enforce the same accounting standards across all of our subsidiaries. Our general rule of thumb is "local before global", meaning that reporting must first and foremost be in line with home-

Profile: Jürgen Hund



Jürgen Hund is CFO of MEIKO Group, based in Offenburg, Germany. He joined the company 4 years ago as Head of Group Accounting. MEIKO provides clean solutions with a comprehensive range of products including small glasswashers, hood type dishwashers and flight and rack type dishwashing machines. It also specialises in complete warewashing systems with conveyor and automation technology and cleaning and disinfection technology for hospitals and care homes.

"We enforce the same accounting standards across all of our subsidiaries. Our general rule of thumb is "local before global", meaning that reporting must first and foremost be in line with home-country requirements."
- Jürgen Hund, CFO, MEIKO

country requirements. The next step is an aggregated report for the HQ in Offenburg, which we can then easily feed into our system once a month. This allows us to easily keep track of all global activities and immediately raise any red flags. For a global company such as MEIKO, it is always advisable to deal with shorter time frames to avoid any surprises. And since China's regulations change very fast, this helps keep an eye on things.

Do you have best practice suggestions?

Training is key when it comes to bridging cultural and business gaps. Take the example of *fapiao* management in China: this concept is completely foreign in Germany! This is why our expats receive thorough training on the subject when they first arrive, from chop management to proper documentation. Even with short placements, we require trainings so that we can achieve the best possible work style and avoid compliance problems. Conversely, since the MEIKO team in China is primarily Chinese with very few Germans, there is also a big language barrier. This, coupled with our unique ERP system make trainings an essential part of our business to ensure congruence across borders.

How do RMB fluctuations impact you?

Since MEIKO has full production capabilities in China, we enjoy a natural hedge as everything is contained within the country. We sell locally in RMB and source in RMB. In addition, we even purchase components there for other global production sites, if the quality and logistics are in line with our expectations. Due to the fact that MEIKO has been cash flow positive in China for the past years, we now reinvest our RMB in buying new machines and equipment or even raw materials. For us, the country is a big growth market and there is still room for more. We will continue to build up our operations there by investing in our people and our set-up. Therefore, all of our activities within China are handled in RMB and we are not really exposed when it comes to currency fluctuations. We produce in China for China so we don't have to worry much about this topic at the moment.

Recently transfer pricing regulations have been getting stricter. Has this affected you?

This is a huge topic for us at the moment – not only in China but globally. Our expertise originates in Germany and we are sharing it

within our company, but to other countries. As it was in our case, I recommend working with a tax advisor, such as Fiducia, in devising an internal model to best manage this and avoid any discrepancies. All of our subsidiaries are treated equally with the same rules. This is critical these days and a topic we will look at every single year to make sure it is still compliant with local and international rules.

What tips do you have for risk management and fraud detection?

Risk and fraud are hot topics in Asia and also for China. Since our business is also project-based, we are confronted with these matters on a regular basis. Our company slogan is "the clean solution" – and with this we don't only mean our superior cleaning technology. It is also our work style, which we enforce on an international level. To achieve this, we have thorough trainings and presentations and make it clear that there are immediate consequences for anyone involved in illicit activities, regardless of level.

What future regulatory trends do you anticipate?

For one, I foresee that China will ease up quite substantially. We can already see this happening now, especially compared to 5 - 10 years ago. It will be easier for foreign companies to operate in China though, of course, the hand of the government will always be there.

In addition, the RMB will become a world currency along with the USD and EUR and will be fully convertible. There have been big steps in this direction already. Due to these factors it will be more straightforward for foreign companies to do business in China. ☘



MEIKO K 160



A compact basket transport washing machine - the MEIKO K 160 is popular in China because it has a very high capacity and a very small space requirement.

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. ☎

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

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

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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