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Accounting  
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INTERNAL CONTROLS IN CHINA





In China, issues in Foreign Invested Enterprises can vary from outright criminal activity to non-compliance issues. Many of these issues are foreseeable but due to lack of internal control and poor management, they can cause severe monetary loss and taint company's reputation.

## Common indicators of having lost internal controls

### 1. Accounting

- Financial report: Allocation of revenue and expenses to wrong periods
- Revenue: Aggressive revenue recognition by creating fake account receivables
- Assets: overestimation of assets are inaccurate depreciation of assets
- Expenses: Use fake expense receipts, apply for reimbursement of unapproved items or apply for reimbursement of the same item multiple times

### 2. Legal

- Intellectual property: Localization, outsourcing and exchange of knowhow may cause IP theft
- Chop: Illegal use of company's chops
- Labor issues: Non compliance with local labor regulations

### 3. Supply Chain

- Inventory: Inventory on the accounting book and inventory in the storeroom never match
- Supply: Purchasing of overpriced raw materials and getting kickback payments in return
- Production: Embezzlement of assets, or key production staff starting competing businesses
- Distribution: Heavy reliance on local agents to distribute products in China
- Sales: Sales of goods at/below cost (due to relationship/inappropriate agreement between sales staff and purchaser)

### 4. HR/ Payroll

- Recruitment: No proper recruitment and background screening process in place
- False payroll claims: Discrepancy between contract salary and payroll payments



## CHECKLIST FOR STRENGTHENING INTERNAL CONTROL

### 1. Accounting

- ✓ Have a third party accountant check your books at least every quarter
- ✓ Carry out limited review/ internal audits from time to time
- ✓ Have more than one level of expense approval, and segregation of duties for approval and expenses is strictly followed

### 2. Supply Chain

- ✓ Accounting stock inventory is regularly matched to stock take inventory, differences are explained and adjusted
- ✓ Conduct due diligence on vendors/ suppliers to ensure they are following contract obligations
- ✓ Keep an eye on the procurement department to ensure they are working in the best interest of the company.
- ✓ Recruit outside assistance to check if sales employees are discounting for bribes or partnering with distributors for personal interest
- ✓ Independently verify volumes of sales or purchases from suppliers

### 3. HR/ Payroll

- ✓ Don't make employees cash payments to
- ✓ Have an independent person review timesheet on a regular basis.
- ✓ Frequently rotate and segregate responsibilities for payroll functions.

### 4. Legal

- ✓ Register your intellectual property rights- this is a cardinal rule and formulate IP protection strategies to ensure its transparency, integrity and security.
- ✓ Have a proper plan in place to ensure that company chop's are accessible and controlled. Never allow just one person to control them all.

