

AUDITING CHINA BANK BALANCES: COMMON ISSUES AND DIFFICULTIES



Auditing bank balances in China can be challenging if the audit is not sufficiently well-planned. The next sections will outline the importance of planning to a China bank balance audit followed by common issues faced in audits, specific to China banks.

IMPORTANCE OF PLANNING

Depending on the scope and the objectives of the audit, common procedures for a China bank balance audit include obtaining board resolutions and bank cards for authorised signatories, and scrutinising bank statements, obtaining bank confirmations, reviewing through bank reconciliations, and review of the controls in place for receiving and payment of cash.

NECESSARY BANK CONFIRMATION

Before fieldwork starts, it is necessary to prepare and send out bank confirmation requests. This requires substantial coordination with both local management and the banks as the mode of confirmation needs to be determined. Within certain Chinese provinces and for certain banks, there is a practice of not responding to written confirmation requests, and instead require the auditor to be present at the bank itself. There are also certain banks that do not entertain foreign auditors, and the bank confirmation requests have to be made through locally registered auditors. Firms with extensive global networks like BDO will have little trouble getting assistance from their local counterparts for such confirmations.

The bank confirmation requests are usually sent out by the company being audited. This is because authorisation from the company with the company seal and authorised signatory is required before the bank can release such confidential information to third parties such as auditors. To ensure authenticity of the bank confirmation, the request must have a reply direct to the auditors, and not through the company being audited. A postage-paid return addressed envelope to

the auditor's address could be provided to help expedite the reply. For walk-in confirmations at the bank, the auditor will have to be physically present to receive the confirmation direct from the bank officer. The auditor may at times make a special request not to be accompanied by any representative of the company. This helps minimise any opportunity for influence over the confirmation process and for additional comfort on the quality of the confirmation obtained. However, this would require the necessary authorisation from the company for the release of information.

Bank confirmations provide good evidence to support the authenticity of the amount reflected in bank statements. In addition, bank confirmations also serve to confirm loan balances, terminated accounts during the year, balances held in trust, details of guarantees and collaterals provided, details of trade instruments such as trade receivables and letters of credit held, foreign currency contracts, and that there are no other balances with the bank other than those listed in the confirmation. Depending on the scope and objectives of the audit, there could also be other items for confirmation requested by the auditor. The bank confirmation also serves to check that there has been no other account and balances, whether credit or debit, not taken up in the accounts of the company.

In many parts of China, the Legal Representative of the company is allowed to open bank accounts without a need for board resolution.

From the discussion above, we see the importance of the planning process, to obtain the necessary bank confirmations in facilitating a smooth audit. The auditor will have to work very closely with local management to obtain the necessary information and adequately prepare so that the visit during audit fieldwork is fruitful.

COMMON ISSUES

Next, we take a look at some common issues specific to Chinese companies. Unlike Singapore or Hong Kong, in China, it is a common practice for the authorised signatory for the operation of bank accounts to use of seals in place of hand-written signatures. Usually, the minimum two seals required are the Legal Representative Seal and the Finance Seal. Some companies may choose to have additional seals for better control of bank accounts.

The reasoning behind dual bank signatories is for proper segregation of duties; to not allow any one person to have full access to the bank account. However, in the context where seals are used in place of signatures, even with dual signatory imposed, the intended control can be overridden if both seals are being kept by an individual, or if an individual has access to both seals. A reason often cited for dual signatory practice is to facilitate operational expediency, so that payments could be processed easily without having both officers in custody of the seals review and approve the payments.

Bank signatories are usually allowed to transact any amounts without any limits imposed. Banks in certain provinces may only recognise a single set of authorised signatories for bank cards regardless of the payment amount. However, more banks in more larger cities such as Shanghai or Shenzhen do accept instructions for different set of signatories for different payment limits.

The rationale for the establishment of payment limits is so that routine and less significant payments can be delegated to certain senior officers in the company, and that other unusual and significant payments above a threshold can be escalated for approval by higher authority, such as the CEO or the Board. However, if all payments are approved by the CEO, there is a risk that certain payments may escape proper review due to the sheer volume of the payments.

Companies usually work within limitations by establishing mitigating controls such as internal payment authorisation limits, regular management reporting to head office, as well as ad-hoc reviews from head office personnel or other professionals so as to keep local management in check. A culture and the conduct of good corporate governance can help mitigate these limitations, but could take considerable education and effort to cultivate.



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