Key Audit Issues & Solutions
for Chinese Companies in 2013

by Drew Bernstein

With the 2013 annual audit season well underway, U.S.-listed Chinese companies continue to experience a high degree of scrutiny from U.S. investors and regulators. Independent auditors, audit committees and management teams will need to resolve complex issues under tight time constraints in the coming weeks. The Securities and Exchange Commission (SEC), along with NASDAQ and the New York Stock Exchange (NYSE), have stepped up requests for supplemental disclosure and testing for Chinese issuers. New tighter deadlines for 20-F filings for foreign private issuers are increasing the pressure on internal accounting staff and CFOs. And the recent SEC charges against the Chinese affiliates of the Big Four accounting firms have raised concerns about the accountability and supervision of these key “gatekeepers” to the U.S. public markets.

With a staff of over 75 professionals in China trained in SEC and PCAOB accounting issues, Marcum Bernstein & Pinchuk (MBP) offers a unique set of resources to Chinese companies who need rapid response solutions to critical accounting issues. We are able to quickly assemble the expertise to support management teams, audit committees, special committees, and legal advisors who need accurate financial and accounting information to support informed decisions. MBP offers the credibility of a PCAOB-reviewed firm that is ranked among the top ten public company auditors in the U.S., combined with a deep understanding of Chinese business practices, accounting standards, and corporate culture.

Based upon our experience, the key issues faced by Chinese companies in 2013 will include:

1. **Delays in SEC Filings**
   Delays in SEC periodic filings can damage investor credibility and, in the worst case, place a company’s U.S. listing status at risk. Often Chinese companies may risk missing filing deadlines due to constraints on internal accounting staffing or lack of detailed knowledge of US GAAP accounting policies and SEC reporting issues. MBP’s Internal Audit Augmentation services can help to fill any gaps in internal resources, improve communications with a company’s independent auditors, and increase the assurance of timely filings. We can help to assess the areas of risk to current reporting practices and internal controls, and then develop effective work plans to remedy them. With deep experience in SEC reporting and disclosure, our professionals can help to properly structure and format accounting data, work papers and reports to enable the company to work most efficiently with external auditors.

2. **Auditor Disagreements**
   Disagreements with independent auditors can potentially cause filing delays or restatements, and if allowed to escalate can even lead to auditor resignations. Limitations on the scope of work by independent accounting firms can contribute to misunderstandings and frustration, while wasting precious time. MBP is able to analyze complex US GAAP and SEC accounting issues and provide advice on alternative courses of action on a confidential basis. We provide independent research and advisory services to clearly support appropriate accounting positions and assist with resolution of outstanding issues with a company’s external auditors. In the event that a restatement is required, MBP can help to effectively respond to questions by regulators and provide the technical expertise to complete the restatement in an accurate and timely manner. If the independent auditor has resigned, MBP can help the audit committee to analyze the root causes of disagreements, educate management on policies necessary for a compliant audit, and provide a high quality, credible alternative for Chinese issuers by a sizable, PCAOB-reviewed audit firm.

3. **SEC Inquiries and Investigations**
   Many Chinese companies are experiencing more frequent inquiries from the SEC, the NYSE and NASDAQ on a range of accounting and financial reporting issues. Requests for cash verification testing, inquiries regarding variable interest entity (VIE) ownership structures, and questions around revenue recognition practices and related party transactions are increasingly common. These inquiries may lead to informal or formal SEC investigations, which can drain management time and resources and irreparably damage corporate reputations. With one of the largest audit practices for U.S.-listed Chinese companies, MBP brings a detailed understanding of the hot button accounting and disclosure issues for the SEC staff and other regulators. MBP can help to formulate comprehensive responses that address both the substance and underlying concerns of SEC inquiries. We can assist with requests to the SEC’s Office of Chief Accountant for accounting guidance and provide technical accounting expertise to boards of directors and audit committees.
4 **Going Private Transactions**
Given the extremely attractive valuations of many Chinese companies, there is a high level of interest among private equity funds and Chinese policy banks in sponsoring “going private transactions” to buy out public shareholders with the intention to relist Chinese companies on domestic exchanges in the future. A management leveraged buyout (MBO) can be an attractive way for the management to increase their ownership stake in the company, while providing a premium over market prices for current public shareholders. However, going private is a very complex transaction that can cost millions of dollars in advisory fees, take over 12 months to complete, and impose substantial legal liability on corporate directors and officers. MBP has the experience to provide in-depth accounting and financial due diligence services to financial sponsors, advisors, and special committees on a cost-effective basis. We also can supplement management resources with an internal audit transaction team in order to support the drafting of required disclosure documents and respond to accounting inquiries from all parties.

5 **Short Seller Attacks/Allegations**
In recent years, Chinese companies have been subject to vehement and often devastating attacks by short sellers, investigative media, and “independent” research firms. Many such reports are supported by what appears to be voluminous evidence that can include Chinese regulatory filings, customer and employee interviews, and surveillance video and photography. Such attacks will often trigger inquiries by the SEC or may lead to suspension of trading in the company’s stock. The drop in stock value often results in a parade of class action lawsuits. The company’s auditors and independent directors may be at risk of resigning if they feel that management is evasive or non-responsive to investor and regulator concerns. MBP offers forensic accounting expertise to legal counsel and special committees of the board to provide reliable answers to questions raised by the allegations of short sellers and data analytics and expert opinions in support of litigation strategies. Our deep bench of forensic accounting experts and detailed understanding of Chinese record-keeping and reporting practices make MBP uniquely qualified to cut through murky fact patterns and reconcile conflicting versions of the truth.

6 **IPO Readiness**
For all the challenges faced by Chinese companies, China remains the fastest growing major economy in the world and investor sentiment can quickly move into a positive direction. When this happens, management needs to be able to move quickly to take advantage of market windows and win investor confidence. MBP’s IPO Readiness services provide pre-IPO companies with comprehensive support to accelerate the process of going public, including internal audit supplementation, assessment of risk and control environments, and training for finance and accounting professionals. We can make sure that once the door to public status opens, your company will move to the front of the line.

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2013 promises to be a transformative year for Chinese public companies. Disclosure and reporting requirements have grown more complex. The timeframe for effective response continues to get shorter. And the failure to provide accurate, reliable and timely accounting information can be catastrophic.

Despite these risks, there is also a strong possibility the capital markets will re-open for higher quality Chinese issuers if policy issues can be effectively addressed. Marcum Bernstein & Pinchuk is positioned to provide a critical resource for Chinese companies seeking to navigate the challenges and rewards of public company status.

**ABOUT MARCUM BERNSTEIN & PINCHUK LLP**
Marcum Bernstein & Pinchuk (MarcumBP), a PCAOB-registered firm, provides a full range of audit and assurance, tax and transaction advisory services for clients in a variety of industries throughout the world. With offices in New York, Beijing, Guangzhou, Shanghai and Hangzhou, MarcumBP provides the expertise, cultural understanding and support needed to efficiently serve and advise our clients. MarcumBP currently provides services to over 30 clients in the China market.

**ABOUT MARCUM LLP**
Ranked among the top 15, Marcum LLP offers the resources of 1,000 professionals, including over 125 partners, in more than 20 offices throughout New York, New Jersey, Massachusetts, Connecticut, Pennsylvania, California, Florida, Grand Cayman and China. Headquartered in New York City, the Firm’s presence runs deep with full service offices strategically located in major business markets. Marcum LLP is a member of the Marcum Group, a family of organizations providing a comprehensive range of professional services including accounting and advisory, technology solutions, wealth management, and executive and professional recruiting. These organizations include Marcum LLP; Marcum Bernstein and Pinchuk LLP; MarcumBuchanan Associates LLC; Marcum Cronus Partners LLC; Marcum Financial Services LLC; Marcum Search LLC; and Marcum Technology LLC.

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