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# China's FY2021 Annual Audit: What's New and How to Prepare?

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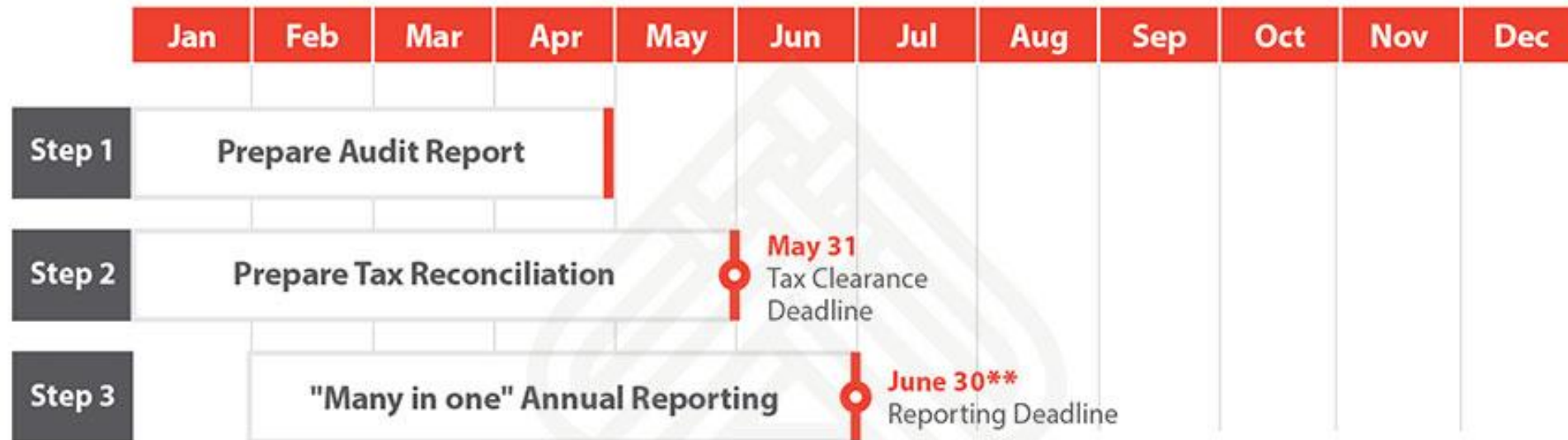
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# I. Typical financial audit process



# Financial audit – timeline and functions

## Annual Compliance Timeline\*

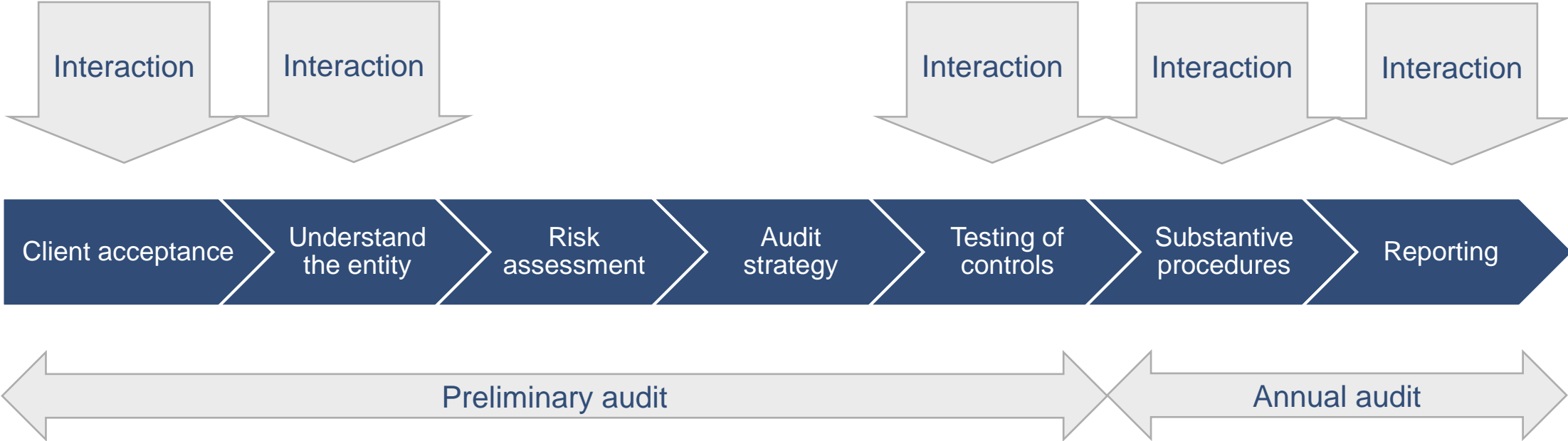


*\*Subject to regional variation*

*\*\*A postponement of the deadline might happen. Please refer to the official notice posted by the authority in charge.*

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# Typical financial audit process





# Substantive procedures - how to prepare

## Examples:

- **Cash count, inventory count and fixed assets inspection**
- **Arrange confirmations**
  - Bank confirmation
  - Related party transactions and balances
  - Selected current account balances
- **The recoverability of receivables**
  - Expected credit loss model
- **Revenue and costs, income and expenses**
  - Accounting vouchers inspection
  - Accrued expenses
  - Fluctuation analysis
  - Corporate income tax adjustments and compliance

## **II. 2021 newly effective accounting standards**



# 2021 new accounting standard - Revenue

## What to prepare:

- Provide sample sales contract
- Justify your identification of performance obligations
- Explain why the performance obligation is satisfied over time or at a point of time
- Justify the stand-alone selling price used in allocating revenue

## Pay attention to:

- Shipping and handling expenses
- One criteria for performance obligation satisfied over time
  - [T]he entity's performance does not create an asset with an alternative use to the entity and the entity has **an enforceable right to payment for performance** completed to date.



# 2021 new accounting standard - Leases

## What to prepare:

- All lease contracts currently in force
- Depreciation schedule of right-of-use assets
- Amortization schedule of lease liabilities
- Justify the discount rate

## Pay attention to:

- Current and non-current portion of lease liabilities
- Composition of right-of-use assets

# 2021 new accounting standard – Financial instruments

## What to prepare:

- **Justify your classification of financial assets and financial liabilities**
- **Provide accounting policy on assessing credit risks**
- **Justify your assessment of credit risks of debtors**

## Pay attention to:

- **The recoverability of receivables – the expected credit loss model**

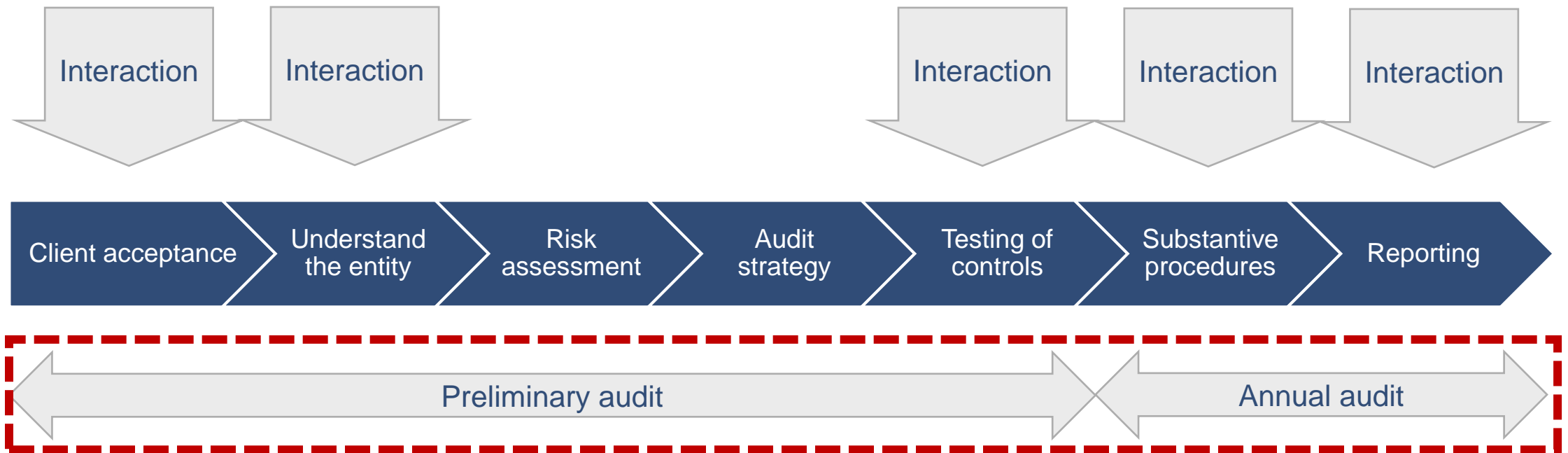
### **III. Covid-19 related issues**



# Covid-19 related issues - Travel restrictions

- **Start the financial audit as early as you can**
  - Allow some buffer time
  - Make use of the preliminary audit
- **Consider the impact of travel restrictions on internal control**
  - Auditors will adjust their risk assessment and audit strategy, leading to:
  - More inquires, more tests of controls, more substantive procedure

# Typical financial audit process



# Covid-19 related issues - Fraud

- **Auditor may particularly focus on fraud risk in 2021**
  - Changes in the control environment
  - Increased pressure on the management
- **In response, auditor may increase the level of professional skepticism**
  - More inquiries
  - Change the usual way of collecting audit evidence



# Covid-19 related issues - Going concern

- **What is going concern**

- The assumption that the entity will continue its operations for the foreseeable future. Assets and liabilities are recorded on the basis that the entity will be able to realize its assets and discharge its liabilities in the normal course of business.

- **Auditor's inquiry**

- What is your assessment of the impact of Covid-19 on the business and what is your plan in response?

- **Factors to consider when answering this question**

- Are there sufficient liquidity to remain solvent through the pandemic and beyond?
- Does the company have any access to financial support?
- Are there any government subsidy available?

# Covid-19 related issues – audit opinions

- **Unmodified opinion** with an emphasis of matter paragraph or a material uncertainty related to going concern
  - Example: We draw attention to note [X] to the consolidated financial statements which describe the impacts of the COVID-19 situation on trading, a forecasted breach of banking covenants within the immediate future and measures taken by the Group which include a proposed capital raise, renegotiated banking facilities including a covenant waiver or securing alternative funding. These conditions indicate the existence of **a material uncertainty that may cast doubt on the Group's ability to continue as a going concern**. Our conclusion is **not modified** in respect of this matter.

# Covid-19 related issues – Modified audit opinions

- **Qualified opinion**
- **Disclaimer of opinion**
  - Example: ...we were **unable to obtain sufficient appropriate audit evidence or satisfactory management explanation to support the [expected credit loss] ECL assessment.** There were **no alternative audit procedures** that we are able to obtain sufficient and appropriate audit evidence as we considered necessary to assess or corroborate the appropriateness relating to the ECL assessment on the loan and interest receivables. We are also therefore unable to satisfy ourselves whether the interest income has properly been recognised in accordance with the accounting policy of the Company during the year. **Consequently, we were not able to determine whether any adjustment to these amounts and the related disclosures thereof in the consolidated financial statements were necessary.**
- **Adverse opinion**

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## Annual Audit and Compliance: Get Ready for 2022

With the scope and penalties of China's social credit system being further clarified in 2021, legal and regulatory compliance has become more important than ever. More attention should be given to the annual compliance procedures as mandated by various governmental departments. In this issue of China Briefing magazine, we walk foreign businesses through the annual audit and compliance process from start to finish.



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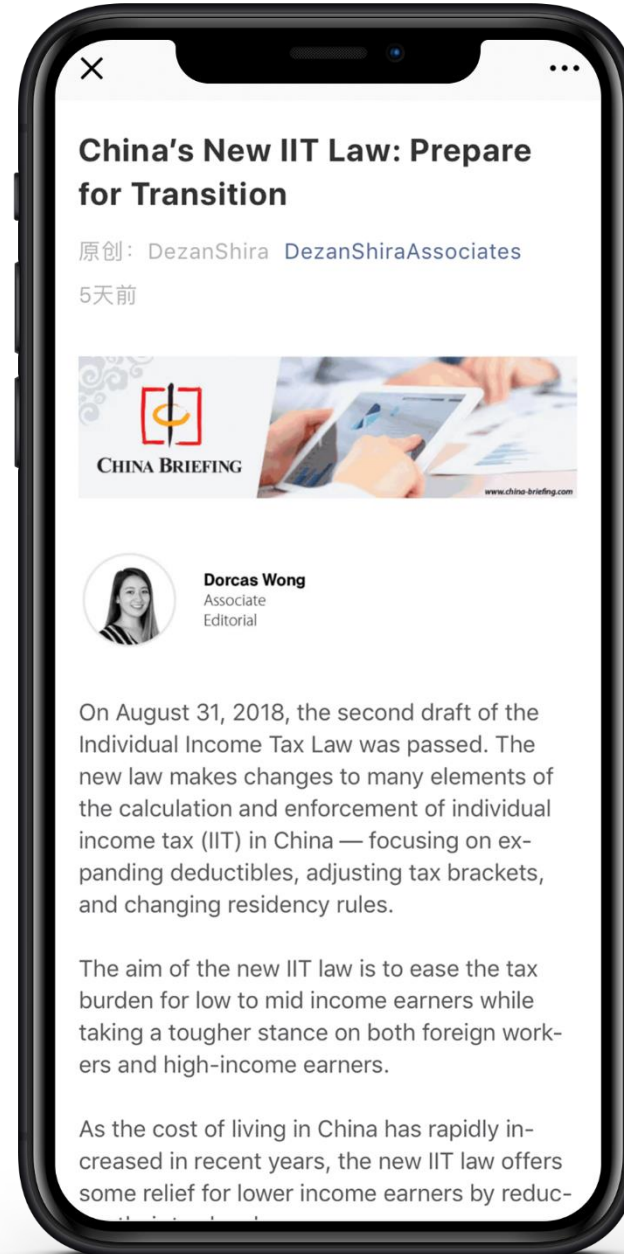


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