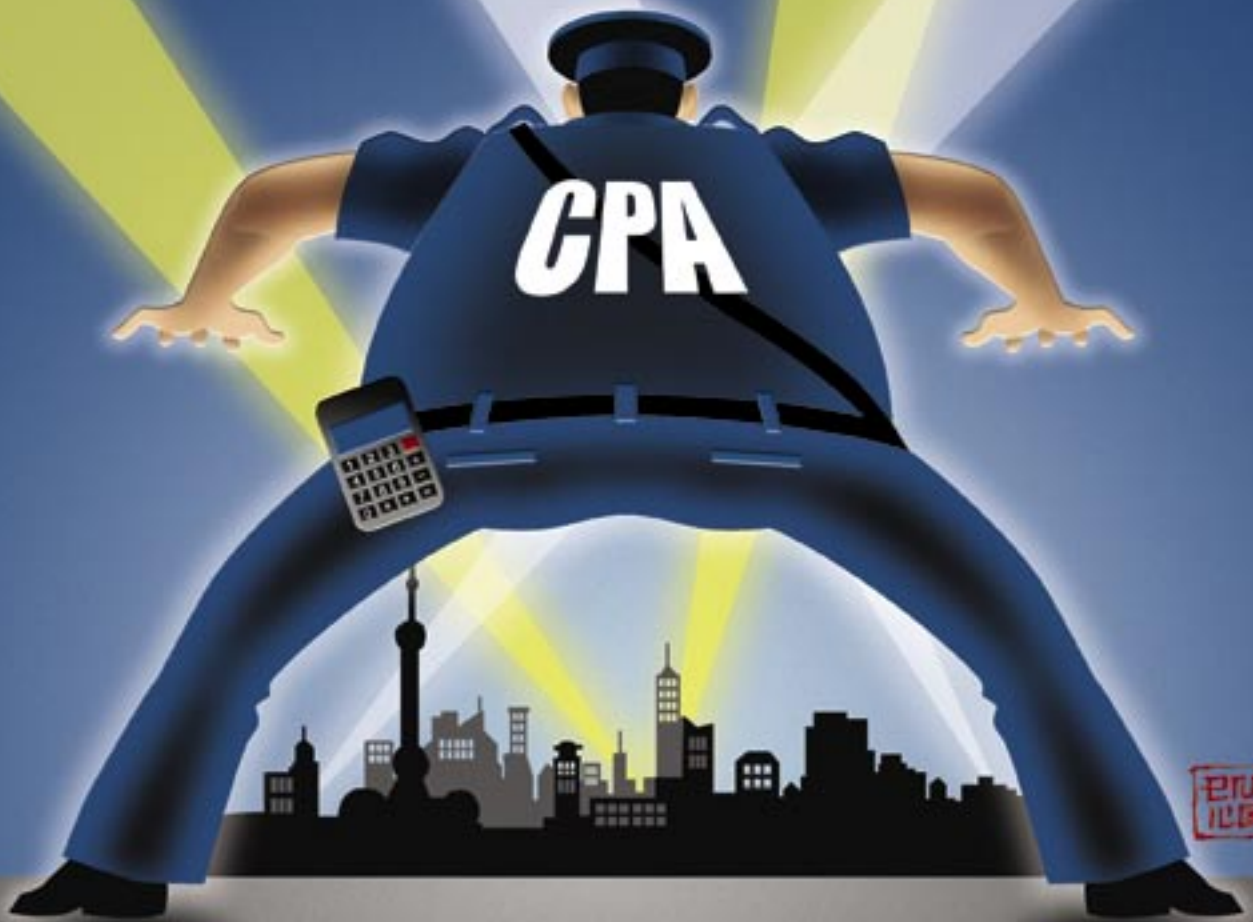


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CPAs in China



# Agent of change

Hong Kong CPAs work on corporate governance in the mainland

By Tavis Lam

As China bursts onto the global stage, mainland Chinese companies, especially those who plan to seek public listings, face challenges from tight regulatory requirements and international practices. Many turn to Hong Kong accountants for their acknowledged abilities to handle issues ranging from compliance to corporate governance.

“There is a skill shortage in China for quality senior finance people,” says Andrew Brushfield, director of recruitment agency Robert Half Hong Kong. “Quite often [the mainland companies] like candidates from Hong Kong because they have greater exposure to multinational practices.”

Mainland Chinese firms have a long way to go with their corporate governance practices, according to a recent Deloitte survey of around 100 mainland-listed companies. It shows that 80 percent of the respondents admit they fail to meet internal control requirements set by mainland regulators.

Deloitte conducted the survey after the State Council released a set of guidelines known as the Pronouncement on Enhancement of the Quality of Listed Companies at the end of 2005

in the hope of cracking down on corruption and other irregularities. The guidelines outlined the responsibilities of regulators, on the one hand, and management on the other, for upholding governance standards such as internal controls, code of practice and fraud elimination. The bourses in Shanghai and Shenzhen released their own guidelines, which became effective in Shanghai in July 2006 and in Shenzhen in July this year.

Danny Lau, head of Deloitte China’s enterprise risk services, which conducted the survey, says, “Internal controls need to be tailor-made because they vary from company to company. Implementing internal control measures require a lot of documentation.” He explains that many Chinese companies fail to comply with the guidelines because top management lack a strong drive to improve governance due to their inadequate technical expertise and the high costs involved.

## Hong Kong expertise

The pressure to improve governance and comply with listing requirements has prompted mainland enterprises to recruit experienced accountants from Hong

Kong. Gilbert Chan is one of them. He joined Advanced Semiconductor Corp. as assistant chief financial officer shortly after the medium-sized Shanghai semiconductor manufacturer raised HK\$775.7 million through an initial public offering in Hong Kong last year.

Chan’s main duties are to assist the company’s CFO, who is not a qualified accountant, with Hong Kong listing rules and compliance. But as soon as he joined the company, he decided to put in place a well-defined risk management plan. That’s why the company’s audit committee hired Ernst & Young to conduct an independent study on its existing practices and risks. The accounting firm identified 15 areas that Advanced Semiconductor should work on as priorities, including authorization, accountability and cost control. Chan says the scheme is a safety net and allows him to work on other operational issues such as budgeting and staff performance. The company also strengthened business ethics by banning employees from accepting or giving gifts, bribes, commissions and other forms of gratuities. “Internal control goes hand in hand with risk management,” he says. Without such proper internal control

measures, companies may well face the risk of fraud or other wrongdoings that threaten their earnings and corporate image. A case in hand is French supermarket chain Carrefour Group, which has 345 stores in the mainland and employs more than 35,000 people. In August, eight Carrefour China managers were detained by Chinese police after an investigation revealed that they allegedly took an undisclosed number of bribes from suppliers, newspapers reported.

The alleged bribery is believed to have stemmed from the company's decentralized procurement system, where local managers at each outlet are allowed to manage pricing, choose suppliers and conduct negotiations on promotional campaigns. *China Business News* revealed in February that a procurement manager with a monthly salary of 3,000 yuan was able to take home bribes amounting to more than a million yuan a year.

### Wake-up call for Chinese enterprises

Such irregularities are common in many parts of mainland China, says Kenny Wong, CFO of SBI E2-Capital Asia Securities Ltd., a Hong Kong investment bank providing services to small and mid-sized enterprises, including mainland companies seeking to list on stock exchanges. He says most of these mainland companies do not have a clear corporate structure – neither do they have board of directors nor independent committees on remuneration and nomination. The company's chairman is often its only decision-maker.

Wong says very often his team has to explain to clients basic listing requirements and help them improve corporate governance before they can go public. "We told them to



## Managing people

### Hong Kong CFOs on managing staff in the mainland

Hong Kong CFOs often experience a culture shock when they go to work in the mainland. Many find managing mainland staff a challenge because the employees have work habits that vastly differ from Hong Kong's. The CFOs say they need to show an understanding of the cultures of employees coming from different hometowns speaking different dialects and adjust their management styles accordingly.

Having worked in Shanghai for a year, Gilbert Chan, assistant CFO of Advanced Semiconductor Corp., says he has learned how best to manage its workforce of more than 1,800 people.

"Those from Hong Kong are familiar with a management style that involves a strong sense of discipline – everything runs according to systems. But it doesn't work in China because they would think you are not part of them. You need to show concern

for them and their families. It is not just about work relationship," he says.

Chan says most of the employees have worked in the company for many years and developed close relations with their colleagues and even suppliers. He cited, as an example, the purchasing department, which supposedly should bargain with suppliers about raw material prices but doesn't. "We ask people at the purchasing department to meet the budget, so that we can get more profit from core-savings. But they are very close to the suppliers," says Chan. The management, however, cannot fire employees for fear that it would upset others and hurt team spirit.

Chan says many of his staff, even the younger ones, stick to regular working hours and refuse to put in extra. "They are happy to go to work in the morning and take off sharply at 5:30 p.m. They enjoy spending time with their family and are not willing to work overtime for money. They will be very upset if you

hold regular board meetings, prepare minutes and other documentation properly," he says. "We also have to explain listing rules and other compliance requirements."

Mainland companies, especially family-owned enterprises, also need to put in place a check-and-balance system because many of them have related-party transaction issues that investors dislike. Wong says companies should avoid getting suppliers that may be relatives of management.

### Improving ethics

Michael Austin, CFO of Hong Kong-listed Top Form International Ltd., the world's largest OEM brasserie manufacturer with clients including lingerie brand Vanity Fair, says financial chiefs in China often have to be creative and flexible to get around problematic practices.

For example, he says Top Form tried to avoid the common practice of

lavishing expensive gifts on mainland officials or taking them out to clubs or karaokes on company expenses to establish good *guanxi* (relations). Instead, when the company set up a factory in Jiangxi province in 2002, management spent 40,000 yuan to sponsor a fireworks display in town rather than bring local officials to dinners or give them gifts. The event attracted as many as 30,000 people and was a huge success, Austin says: "We had hundreds of people queuing outside our plant wanting a job the next day. The fireworks gave the town officials status. It benefited them and benefited us as well."

Top Form currently employs 7,000 employees in three factories in Guangdong and Jiangxi provinces. Austin, based in Hong Kong, makes frequent trips to the factories to ensure production standards and staff compliance with rules and regulations.

In 2000, the company established

a code of conduct, which clearly lists the "dos" and "don'ts" in the entire production process. For example, staff who handle price sensitive information have to sign contracts to avoid leakage. Kickbacks are prohibited when dealing with suppliers, and child workers and forced overtime are strictly banned. Austin says the company has been fine-tuning the code since he joined the company in 2004.

"The code is the standards we set to manage ourselves, both internally and externally, and in terms of social responsibility and the environment," he says.

Austin holds monthly meetings with senior management to address problems from different departments.

"Internal controls help secure the company's succession planning. It sends the right message to shareholders, employees and financiers, and it helps guard against corruption and nasty surprises," he says. **A+**

ask them to come in during weekends," Chan says. He believes such a bureaucratic working style stemmed from the fact that the company was originally a state-owned enterprise set up as a research project by the State Council.

"It is a dilemma, because you want to be efficient, but in a way you will dismantle your foundation if you do it too quickly. You are riding on their platform, but effectively breaking it up. You've got to be very skilful," Chan says.

Manufacturers in the Pearl River Delta, however, are another story. With more than 7,000 employees in Guangdong and Jiangxi, Michael Austin, CFO of lingerie manufacturer Top Form International Ltd., says he is impressed by the diligence of the workers, many of whom are from the rural areas of Sichuan and Hunan provinces and eager to make some quick cash before returning home for good.

"The other countries can't do it with the same efficiency as China. If you ask someone in China to work overtime, or

occasionally double shifts, it's fantastic. They rub their hands with more money," Austin says.

He remembered in 2005, when the European Union imposed a new quota limit on Chinese exports, the company was forced to reshuffle its production among its other regions because of quota availability. They moved their European production from China to Thailand and the Philippines, and the U.S. production into China. He expected the workers in different countries to take some time to adapt to the changes and that this would affect the company's profits. To his surprise, because of China's efficient workforce, which was responsible for half of the company's production, things returned to normal in just a few months.

In recent years however, China is losing its edge of having a cheap and efficient labour supply due to the constant wage increases. "We are seeing labour shortages, particularly in the coastal region," Austin says. "And the wages are getting higher all the time."