

# APERCU



## MESSAGE FROM CHIEF EXECUTIVE OFFICER

Dear clients and friends,

I am honoured to welcome you to this edition of APERCU as BDO's new Chief Executive Officer.

Our firm was established in 1981, and I have been with it for the past 23 years. During that time, BDO has experienced tremendous growth and changes. Our staff headcount has leapt from 20 to 1,000. We have developed from a purely outsourcing service provider into Hong Kong's fifth-largest accounting firm offering a diversity of professional services to clients which include almost 10% of the city's publicly listed companies.

However, what has not changed is our commitment to providing exceptional client service and upholding our core values of integrity, professionalism, quality and being client and employee centred. That will continue.

I would like to thank you for your business and continuing support, and I look forward to us working together, hand in hand, as we all continue to thrive.

Enjoy your reading!

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## EARNINGS PER SHARE

The growth of China's gross domestic product (GDP) has slowed down from double digits in recent years to an estimated 7-8% in 2012, and the hard or soft landing of the country's economy has become a hot topic in the financial community. GDP is the market value of all officially recognised final goods and services produced in a country during a given timeframe, and it is a key measure of its economic growth. The public is sometimes more concerned about GDP per capita, which takes the country's population into account and is often regarded as an indicator of its standard of living.

In fact, there are similar ways to evaluate a listed company's performance. Investors are usually concerned about a listed company's earnings, which form the basis for its share price. Earnings

per share (EPS) amount is therefore the most commonly used tool to assess a company's performance. It takes into account the number of ordinary shares, and the way it is calculated and presented is governed by Hong Kong Accounting Standard 33 "Earnings per Share" (HKAS 33). Commonly used in financial analysis, EPS is also a component of Price/Earning (P/E) that is widely used for making investment decisions. Because of its importance to financial statement users, a listed company's EPS must

be disclosed in its statement of comprehensive income in accordance with the requirements of HKAS 33. There are two kinds of EPS – Basic and Diluted. This article will look at some areas of basic EPS.

Basic EPS is calculated by dividing the profit or loss attributable to equity owners of the reporting entity by the weighted average number of ordinary shares outstanding during the accounting period:

$$\text{Basic EPS} = \frac{\text{Profit or loss attributable to equity owners of the reporting entity}}{\text{Weighted average number of ordinary shares outstanding during the accounting period}}$$

The elements in this formula can be further described as follows.

### 1.1 Profit or loss attributable to equity owners

The profit or loss attributable to equity owners of the reporting entity for a period is calculated as:

- Profit or loss for the period (after all items of income and expense including tax) **adjusted for**
- Post-tax amount of preference dividends, differences arising on the settlement of preference shares, and other similar effects of preference shares classified as equity.

The above adjustment only relates to "irredeemable" preference shares, as the amounts relating to preference shares that are classified as debt (ie redeemable preference shares) are already included in the profit or loss for the period.

Preference dividends adjusted from profit or loss for the purpose of calculating basic EPS consist of the following items:

- Post-tax amount of preference dividends on non-cumulative preference shares declared during the period; and
- Post-tax amount of preference dividends on cumulative preference shares required for the period, whether or not they have been declared, excluding the amount of preference dividends for cumulative preference shares that have been paid or declared during the current period in respect of previous periods.

If an entity repurchases its own preference shares with a fair value for the consideration paid to preference shareholders that exceeds their carrying amount, the excess should be regarded as a return to the preference shareholders and deducted from the profit or loss attributable to equity owners for the purpose of calculating basic EPS. On the other hand, any excess of the carrying amount of preference shares over the fair value of the consideration paid to settle them is added in calculating profit or loss attributable to equity owners of the parent entity.

The above adjustments for preference shares are also applicable to other participating equity instruments.

## 1.2 Weighted average number of ordinary shares

When calculating basic EPS, the denominator must be the weighted average number of ordinary shares that were outstanding during the period, not the actual number of ordinary shares at the end of the period. It is calculated by adjusting the number of ordinary shares that were outstanding at the beginning of the period by the number of ordinary shares bought back or issued during the period, multiplied by a time-weighting factor.

The time-weighting factor is the number of days the shares were outstanding, compared with the total number of days during the period. Shares are usually included in the weighted average number of shares from the date when the consideration for the issue of shares is receivable, which is often the date they were issued. The guidance for applying this rule under different situations is as follows:

Consideration for issue of shares	When the shares are included in the calculation of the weighted average number of shares
Cash	The date cash is receivable
Conversion of a debt instrument into ordinary shares	The date interest ceases to accrue
In place of interest or principal on other financial instruments	The date interest ceases to accrue
In exchange for the settlement of a liability of the entity	The settlement date
In settlement for the acquisition of an asset other than cash (Note)	The date when the acquisition is recognised (ie the date of acquisition)
In exchange for the rendering of services to the entity	The date when services are rendered

*Note: Ordinary shares issued as part of a purchase consideration in a business combination are included in the calculation of the weighted average number of shares from the date of acquisition, ie the exact date when the acquired entity's financial statements are consolidated in the acquirer's financial statements.*

### Mandatorily convertible instruments and contingently issuable shares

It is worth mentioning that, shares of a mandatorily convertible instrument are included in the calculation of the weighted average number of ordinary shares from the date when the contract for the mandatorily convertible instrument was entered into. On the other hand, contingently issuable shares are included in the calculation of the weighted average number of ordinary shares after all the necessary conditions for their issue have been satisfied. In that context, the shares concerned should be included in the calculation even before they were actually issued.

### Bonus issues, share splits, reverse share splits and rights issues

Furthermore, changes sometimes take place in an entity's capital structure (an increase or decrease in the number of ordinary shares) without a corresponding change in resources. HKAS 33 requires the weighted average number of ordinary shares to be adjusted for such events that take place during the period and for all periods presented in the financial statements. In particular, if these changes occur after the reporting period but before the financial statements are authorised for issue, the EPS calculations for those and any prior period financial statements presented shall be based on the new number of shares (ie such events are accounted for retrospectively). Bonus issues, share splits, reverse share splits and rights issues are common examples of such events.

Bonus issues and share splits are similar in that ordinary shares are issued to existing shareholders for no additional consideration. During bonus issues or share splits, the number of ordinary shares increases without any increase in the entity's resources. On the other hand, reverse share splits consolidate ordinary shares, and they generally reduce the number of ordinary shares without a corresponding reduction in the entity's resources.

The number of ordinary shares outstanding before such events must be adjusted for the proportionate change in the number of shares outstanding, as if the bonus issues, share splits and reverse share splits had occurred at the beginning of the earliest reported period. The preparers of the financial statements must adjust all the basic EPS figures presented therein.

#### Example 1: Bonus issue

Financial year-end date	31 December
Profit attributable to ordinary equity owners of entity in 2010	HK\$3,000,000
Profit attributable to ordinary equity owners of entity in 2011	HK\$6,000,000
Ordinary shares outstanding from 1 January 2010 to 31 July 2011	1,000,000 shares

Bonus issue on 1 August 2011:

2 bonus shares for each ordinary share outstanding as at 31 July 2011	
= 1,000,000 x 2	2,000,000 shares

Basic EPS 2011

$$= \frac{\text{HK\$6,000,000}}{(1,000,000 + *2,000,000)} \quad \text{HK\$2}$$

Basic EPS 2010 (restated)

$$= \frac{\text{HK\$3,000,000}}{(1,000,000 + *2,000,000)} \quad \text{HK\$1}$$

Basic EPS 2010 (original)

$$= \frac{\text{HK\$3,000,000}}{1,000,000} \quad \text{HK\$3}$$

\* Since the 2,000,000 bonus shares were issued without any additional consideration, the bonus issue is accounted for as if it had occurred at the beginning of 2010, which is the earliest period presented in the entity's annual financial statements in 2011, and the basic EPS of 2010 presented therein is restated.

A rights issue is an issue of new shares to all existing shareholders, usually at a price below the prevailing market price. Since the issue price is below market price, a rights issue is regarded as a combination of the issue of new shares at fair value and a bonus issue. When calculating the weighted average number of ordinary shares under a rights issue, the following adjustment factor is required:

$$\text{Adjustment factor} = \frac{\text{Market value per share immediately before the rights issue}}{\text{Theoretical ex-rights price (TERP)}}$$

TERP is the theoretical price at which the shares would trade after the rights issue, and it takes into account the diluting effect of the bonus element of the rights issue. It is calculated by adding the aggregate market value of the shares immediately before the rights issue to the proceeds from the rights issue, and then dividing this by the total number of shares outstanding after the rights issue. It is always easier to understand this concept from an example, so let us take a look at the following:

### Example 2: Rights issue

Profit attributable to an entity's equity owners in 2010	HK\$6,000,000
Profit attributable to an entity's equity owners in 2011	HK\$7,200,000
Ordinary shares outstanding before the rights issue	1,000,000 shares
Rights issue	
1 new ordinary share granted under the rights issue for each 5 ordinary shares outstanding	
= 1,000,000 / 5	200,000 shares
Exercise price of the shares under the rights issue	HK\$3
Date of the rights issue	1 October 2011
Market price of 1 ordinary share immediately before the rights issue	HK\$6
1. TERP is calculated as:	
$\frac{(1,000,000 \times \text{HK\$6}) + (200,000 \times \text{HK\$3})}{(1,000,000 + 200,000)}$	HK\$5.5
2. The adjustment factor is therefore HK\$6 / HK\$5.5	1.09
3. The weighted average number of ordinary shares for 2011 is calculated as:	
1 January to 30 September 2011	
1,000,000 shares x 1.09 (adjustment factor) x 9/12 (time-weighting factor)	817,500
1 October to 31 December 2011	
1,200,000 shares x 3/12 (time-weighting factor)	300,000
	<u>1,117,500</u>
Basic EPS 2011	
= HK\$7,200,000 / 1,117,500	HK\$6.4
Basic EPS 2010 (restated)	
= HK\$6 (original 2010 Basic EPS) / 1.09 (adjustment factor)	HK\$5.5
Basic EPS 2010 (original)	
= HK\$6,000,000 / 1,000,000	HK\$6

Since the bonus element of the rights issue was made without any additional consideration, it is accounted for as if it had occurred at the beginning of 2010, which is the earliest period presented in the entity's annual financial statements in 2011. The basic EPS for 2010 presented therein is restated using the adjustment factor.

So apparently basic EPS is not that basic. We will talk about diluted EPS in the next issue of APERCU.

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# ANTI-MONEY LAUNDERING, COUNTER-TERRORIST FINANCING, FATCA – ARE YOU COMPLIANT?

Although the level of crime in Hong Kong is relatively lower than in other parts of the world, and there are thus fewer sources of illicit proceeds being generated here, the risk of the underworld using the city's well-developed financial services infrastructure to launder such proceeds should not be underestimated. As an international financial centre in the heart of Asia, Hong Kong's convenient and far-reaching fund-remittance network can be attractive to criminals seeking somewhere to place, launder and integrate illicit funds.

Organisations – especially financial institutions such as banks, securities brokerages, insurance institutions, money changers and remittance agents – must stay alert to and put in place adequate safeguards against the latest tactics being used by money launderers, including online and mobile transactions, prepaid items and digital currencies. They need to be knowledgeable about the newest anti-money laundering regulations and guidelines, at both local and international levels, and they also need to increase their awareness of money laundering, adopt strong preventative measures that comply with the latest regulations, and monitor the effectiveness of those measures continuously.

Furthermore, they need to establish new anti-money laundering policies and procedures and assess their existing ones, as well as conduct relevant know-your-customer and customer due-diligence training for their staff. They must check databases of politically-exposed persons, conduct data analytics to identify possible red flags, report suspicious activity, compile, retain and review records and documentation, and regularly monitor the robustness of their overall anti-money laundering programmes.

From a regulatory perspective, law-enforcement agencies recently seem to have begun taking a more proactive approach towards financial institutions that do not comply with relevant anti-money laundering and/or counter-terrorist financing requirements. This is evident from media coverage about financial institutions that may have violated anti-money laundering requirements in certain jurisdictions. Such news has been widely reported in Hong Kong too.

Reports about the fines being imposed on the financial institutions concerned have undoubtedly alarmed the financial services sector and the investment community as a whole. We have already seen companies conducting increasingly frequent independent reviews of their existing anti-money laundering procedures.

Although most of the enforcement actions have been taken against financial institutions, every type of business – including professional firms, estate agencies, metal dealers and trust and company service providers – who regularly handle clients' money or property should be concerned about falling foul of the relevant legislation. Aside from the swingeing fines imposed in recent cases, there can also be reputational damage, and, given the global presence of many large organisations, additional action such as revoking operating licenses by regulators in certain jurisdictions. Businesses in Hong Kong should therefore conduct an immediate independent review of their current anti-money laundering policies and processes, and implement any improvements needed to mitigate the risk of non-compliance.

Moreover, media reports indicate there was a substantial surge in the number of suspicious activity reports received in some parts of the world last year. A large proportion of these reports could be related to illicit proceeds being transferred out of certain countries following political unrest. In addition, a growing number of the reports are related to fraud, such as collusion to misappropriate funds, bribery, corruption and illegal kickbacks or rebates. The rise in fraudulent activity is not unexpected, given the increase in illicit proceeds being laundered due to the continued slowdown in the global economy. Employers should therefore also be highly vigilant about any possible employee misconduct or fraudulent behaviour occurring in their organisations.

The Hong Kong government has been stepping up and strengthening anti-money laundering and counter-terrorist financing legislation. In addition to the Organised and Serious Crimes Ordinance and the Drug Trafficking (Recovery of Proceeds) Ordinance, which are established legislations that prohibit money laundering and terrorist financing and impose obligations and duties on individuals to report suspicious activities, the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance became effective on 1 April 2012.

The Hong Kong Monetary Authority and Securities and Futures Commission also issued guidelines on these subjects in July 2012. These emphasise the importance of financial institutions putting risk-based measures into place, such as customer identity verification and due diligence; the procedures to be observed in correspondent banking, private banking, wire transfers and overseas/offshore operations; reporting of suspicious transactions to the Joint Financial Intelligence Unit, the Hong Kong Monetary Authority and other relevant parties; record keeping; staff training and on-going monitoring.

Besides the above, financial institutions and other relevant organisations in Hong Kong and overseas should ensure they keep up to date with the latest standards and laws, such as the United Nations (Anti-Terrorism Measures) Ordinance, United Nations Sanctions Ordinance, the US Bank Secrecy Act and Patriot Act, as well as updates contained in relevant gazetted lists and sanctions databases, rules and guidelines. They should also keep up to speed with recommendations issued by the inter-governmental body Financial Action Task Force.

In addition, the US Foreign Account Tax Compliance Act (FATCA) has just become effective on 1 January 2013. This requires all foreign financial and non-financial (ie non-US) enterprises to report information about their US customers, such as accounts held and/or assets owned by US citizens or entities, to the US Department of Treasury on an annual basis, so long as the US customers concerned actively or passively conduct any transactions that might involve "withholdable" income (eg US-sourced proceeds). In line with the requirements of anti-money laundering regulations, FATCA will also increase the compliance obligations of organisations, as they may need to reassess and re-ensure that their know-your-customer and due diligence procedures are robust and effective in identifying all relevant US entities and transactions in their customer databases.

In summary, financial institutions and organisations that are subject to anti-money laundering, counter-terrorist financing and FATCA rules will have to adopt relevant policies and procedures, and ensure these are fully implemented, and have the pertinent systems monitored and assessed independently on a regular basis, in order to assess whether they are effective and compliant with the rules and regulations at all times.

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# COMPLIANCE WITH GLOBAL ANTI-CORRUPTION LAWS

## Anti-corruption initiatives

Corruption can be loosely defined as a payment, offer, authorisation or promise to pay money or anything of value to a public or private official, directly or indirectly, in order to influence, induce, or secure an advantage. Because there are no universal guidelines for dealing with corruption, businesses and individuals have taken advantage of grey areas and loopholes. That does not mean combating corruption is a hopeless cause – the United States and United Kingdom have

revamped their efforts to tackle it, and they are dedicated to prosecuting guilty companies. Bribes and corrupt activities by companies will be investigated under their respective regulations.

**The Foreign Corrupt Practices Act (FCPA)** is a US federal law signed into effect by President Jimmy Carter in 1977. The Securities and Exchange Commission (SEC) and Department of Justice (DOJ) conduct most investigations and prosecutions under it. Its two primary provisions

address accounting transparency and bribery of foreign officials.

**The UK Bribery Act** is an Act of Parliament that came into effect on 1 July 2011, after much debate. It covers criminal law relating to bribery. The Act has a near-universal jurisdiction, and it has been described as "the toughest anti-corruption legislation in the world". As a result, British businesses have become more cautious about anti-corruption measures than their foreign competitors.

## Key differences: offences and defences

Foreign Corrupt Practices Act – FCPA	UK Bribery Act
Bribery of public and private-sector individuals, including foreign government officials	Bribery of public and private sector individuals, including the separate offence of bribing a foreign public official
Only penalises those who offer bribes	Accepting bribes is also punishable
Prosecutes active participants in bribery, along with acts to conceal, omit or otherwise disguise the recording of such transactions	No accounting offence, but includes the offence of failing to keep adequate accounting records
Compliance programmes can be regarded as a defence during the prosecution and sentencing stages	"Adequate procedures" is the only potential defence available against failing to prevent bribery
Statutory exception for "facilitation payments"	"Facilitation payments" are only permitted if local written law allows them
Reasonable and bona fide expenditure on travel, lodging and entertainment is permitted if directly related to the promotion of a product or service, or to perform a government contract	No express exception for corporate hospitality, but guidance advises that "reasonable and proportionate" hospitality is permissible
Up to a five-year prison sentence for bribery, 20 years for accounting offences.	Maximum 10-year prison sentence; other offences may be prosecuted under different statutes
Criminal fines for entities of up to US\$2m for bribery or US\$25m for violation of accounting provisions. (Individuals: fines up to US\$100,000 or US\$5m)	Unlimited fines, confiscation of monies received, director disqualification, etc

## Predictions in the US

There has been a significant increase in the number of successful cases, along with fines, in 2012. That is largely due to the government's use of aggressive investigative tactics, such as undercover operations and wiretaps. However, the major reason is Dodd Frank's whistleblower bounty programme, which took effect on 12 August 2011. Whistleblowers can be awarded 10-30% of settlements over US\$1m; but they must file a complaint internally 120 days before contacting the SEC. The Dodd Frank programme averages 30,000 complaints a year, with one or two credible complaints every day.

## How will anti-corruption laws affect doing business with China?

Guanxi is perhaps the first word any businessperson learns in China. It translates as "relationship" or "connection". The concept stems from ancient Chinese history. It reflects traditional values of loyalty, accountability and obligation. To give gifts and make promises to become long-lasting business partners and frequent visits to strengthen ties are cultural norms built into Chinese values in even the most humble families. Guanxi is very important for doing business in China, and it is a key factor in developing successful relationships.

It is interesting to note that the FCPA has a "statutory exemption" for facilitation payments, which hints that certain guanxi or "palm-greasing payments" fall into a grey area. The UK Bribery Act only allows facilitating payments if they are permitted in the local law. Thus, as mentioned earlier, it compels British businesses to be extra-cautious.

## Prevention guidelines and methods (adequate procedures)

As the laws state that adequate procedures are the only defence a business has if it is prosecuted. Below are some prevention guidelines.

Anti-corruption policies and procedures	Risk assessment	Training and awareness	Due diligence
Understandable	Company-wide process	Multiple methods of delivery	Third-party management programme
Use of situations and examples	Conduct on a routine basis	Conduct annually	M&A reviews
Well defined terms	Identify risk factors	Use case studies	Structure according to risk level
Consistently applied	Define specific scenarios	Use games and other interface tools	Business sponsors
Communicated broadly	Include relevant personnel	Focus training on level of risk	Clearly defined programmes
Strong tone at the top	Produce heat maps	Stress compliance	Use in-country resources
Supportive management		Third-party training	On-site interviews/document reviews
Communicate values			
Reinforce cultural norms of compliance			

**Third parties – red flags (adequate procedures)**

A company should investigate all red flags that involve agents, joint-venture partners, brokers, consultants, distributors, professional service firms, etc. Red flags can include, but are not limited to:

- Transactions in high-risk countries;
- Objections to anti-compliance contractual provisions;
- Unusual payment arrangements (requests for cash payments, excessive commission rates, payments to offshore accounts);
- Known affiliations with corrupt officials; and
- No significant experience relevant to the business.

An acquiring company can be held liable for FCPA violations that occurred prior to the acquisition. Corruption risks will also affect merger and acquisition considerations, including:

- Value of a target company;
- Acquisition structure; and
- Warranties and indemnification.

To limit exposure, the acquiring company must conduct a due diligence review and respond adequately to red flags.

**Periodic evaluation**

According to US Federal Sentencing Guidelines, an effective compliance and ethics programme should also include monitoring to detect criminal conduct, as well as follow-up examinations. The organisation must also periodically assess the risk of criminal conduct, and take appropriate steps to design, implement or modify the programme in order to reduce the risk of criminal conduct identified during this process. The right table is a general breakdown of such efforts.

<b>Objective</b>	<ul style="list-style-type: none"> <li>• Detect and deter violations</li> <li>• Detect training issues</li> <li>• Reassess risk profile</li> <li>• Evaluate compliance programme's effectiveness</li> <li>• Raise profile of compliance</li> <li>• Satisfy expectations of executive board and government</li> </ul>
<b>Lessons learned</b>	<ul style="list-style-type: none"> <li>• Get lawyers and internal auditors talking early</li> <li>• Give internal auditors a head start</li> <li>• Fully understand the facility's operations before going on-site</li> <li>• Clearly define roles and expectations of all team members</li> <li>• Sufficient time to schedule report-writing and remediation</li> <li>• Clearly define the purpose of audits, and the differences between them and traditional audits</li> <li>• Explore all technology options to assist the audit</li> <li>• Carefully track and document remediation</li> <li>• Communication with management and facilities is critical to success</li> </ul>
<b>Reporting and response</b>	<ul style="list-style-type: none"> <li>• Mechanism for reporting policy violations or other misconduct</li> <li>• Reinforce doing the "right thing"</li> <li>• Whistle-blowing protection, confidential reporting</li> <li>• Guideline for prompt resolution</li> <li>• Independent and objective response to concerns</li> <li>• Investigation by trained and competent personnel</li> </ul>
<b>Remediation</b>	<ul style="list-style-type: none"> <li>• Root cause analysis</li> <li>• Enhance the effectiveness of internal controls</li> <li>• Training and awareness refresher courses</li> <li>• Zero-tolerance for non-compliance</li> <li>• Self-reporting</li> <li>• Revised policies and procedures</li> </ul>
<b>Communication</b>	<ul style="list-style-type: none"> <li>• Educating employees/management about policy violations</li> <li>• Update on policy revisions</li> <li>• Reinforce the importance of company policy and consequences of violating it</li> <li>• Revised training materials</li> <li>• Report success of programmes</li> </ul>

Source: www.iaa2012ic.org

To summarise, corruption is no longer an acceptable business model, regardless of cultural norms. The FCPA and UK Bribery Act have an impressive track record of successfully stopping this type of activity. CEOs of large multinational companies are serving prison sentences, as well as being subjected to enormous fines ranging up to hundreds of millions of dollars. Aggressive methods like the whistleblower bounty programme are signs that governments are seriously tackling corruption. It is increasingly important to stay informed about the progress of anti-corruption measures, and to remain committed to compliance with anti-corruption laws.

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# BDO GLOBAL YEAR-END RESULTS SHOW GROWTH

The combined fee income of all BDO Member Firms amounted to €4.63 billion/US\$6.015 billion for the year ended 30 September 2012. This was an increase of 13.98% in euro terms compared to the previous year, and 6.11% when measured in US dollars.

The percentages contributed by fees for various service lines throughout the BDO network remained similar to previous years. There was a slight increase in advisory services to 21%, while audit and accounting services and tax remained steady at 61% and 18% of total fee income, respectively.

As of 30 September 2012, BDO provided services in 138 countries. There were corresponding increases in the numbers of BDO's partners and staff members, as well as the number of BDO offices. These rose to 54,933 people and 1,204 offices.

BDO's revenues grew fastest in the Asia Pacific region during 2011/12. Their impressive 48.5% leap was driven by BDO in China and Japan.

# WILL EMPLOYEE CHOICE ARRANGEMENT SATISFY EMPLOYEES?

The long-awaited Employee Choice Arrangement (ECA, also known as MPF Semi-Portability) finally came into effect on 1 November 2012.

According to the Mandatory Provident Fund Schemes Authority (MPFA), its implementation aims to give employees greater choice concerning MPF trustees and schemes. Hence, it will encourage them to manage their MPF investments more actively and promote greater competition between MPF trustees as a way to bring MPF management fees down.

Under the ECA transfer rules, employees are now allowed to transfer to an MPF scheme of their choice the full amount of the accrued benefits derived from their portions of the mandatory contributions in the contribution account of their employer's selected MPF schemes once per calendar year (ie anytime between 1 January and 31 December).

They are still not allowed to transfer the portion of accumulated mandatory contributions paid by their current employer to another MPF trustee's scheme.

There is no change to the rights of employees or self-employed persons concerning the transfer of accrued benefits derived from former employment or self-employment. Employees can transfer at any time the accrued benefits from their former employment in a lump sum from the preserved account (now renamed as a personal account) to their contribution account with the MPF trustee and scheme of their current employment. Meanwhile, self-employed persons can continue to enrol with MPF trustees and schemes of their own choice.

The transfer arrangements for voluntary contributions are subject to the rules governing the MPF schemes concerned.

The transfer rules for the ECA are summarised in **Table 1** below.

The transfer rules before and after the launch of the ECA are summarised in **Table 2** below.

Employers concerned about the increased administrative work involved in managing their employees' transfer of accrued benefits after the launch of the ECA should relax. There will be no

change to their administrative arrangements, and they do not need to be involved in the transfer of accrued benefits under the ECA.

Nevertheless, employers will still be responsible for choosing the MPF trustee and scheme for their employees, for enrolling new employees in the MPF scheme chosen by the employer, and for contributing to the original MPF scheme for employees, irrespective of whether or not they have transferred the accrued benefits to the MPF schemes of their choice.

Employers are still allowed to offset the employer's portion of accumulated accrued benefits against severance and long service payments to employees.

Although employers are not involved in administering transferred benefits, they should help employees complete the transfer election form smoothly by providing them with the name of the existing trustee, the participating scheme and company, and the employer's account number.

To help employees manage their MPF contributions effectively, employers should perhaps also review the overall performance of their existing MPF trustee and scheme to see if these meet expectations. They may consider setting up one or more MPF schemes with other MPF trustees and schemes, to allow employees to choose their preferred one, organise seminars by inviting existing and new MPF trustees to provide employees with relevant information, etc.

From the employees' prospective, if they are satisfied with the original trustee and scheme, they do not need to transfer their accrued benefits immediately after the launch of ECA. They may consider keeping the accrued benefits in the original scheme and making a decision later, according to their personal needs.

If employees wish to transfer their accrued benefits to their preferred MPF trustee, they are required to contact the new trustee directly for the necessary arrangements to be made.

Before deciding to transfer accrued benefits to a new scheme, employees should consider the following factors:

- 1 The risks involved in the process of transferring accrued benefits between the original and new trustees;
- 2 The background of the new trustee, the range of fund choices offered by its schemes, the risk level and performance of those funds, quality of services, fee and charges, etc; and
- 3 Personal factors, such as individual investment objectives, number of years to retirement, risk-tolerance level, etc.

**Table 1**

Mandatory contribution	Employer's portion	→	Preserved in employer's scheme
		→	Non-transferrable
	Employee's portion	→	Allow to transfer the accrued benefits in full once a calendar year to scheme of his/her own choice
	From former employment	→	Allow to transfer the accrued benefits in full to scheme of his/her own choice freely
Voluntary contribution - no change, pertain to rules in the particular schemes			

**Table 2**

Employee MPF contribution account		Before the amendments	After the amendments
Mandatory contribution	Employer's portion	Non-transferrable	Non-transferrable
	Employee's portion		Transferrable (once a calendar year)
	Portion from former employment		Transferrable (freely)
Voluntary contribution		Follow the rules in the particular schemes	Follow the rules in the particular schemes

Employees should take this opportunity to review their investment portfolio and take appropriate action to improve their investment returns.

After 12 years of implementation, the MPF system has been widely criticised by Hong Kong's citizens (you may recall the massive objection to the Financial Secretary's proposal to inject HK\$6,000 into every MPF account as one of the relief measures in his 2011/12 Budget). The main criticism has been that contribution limits are too low and costs too high, and that returns are insufficient to provide a satisfactory retirement lifestyle.

The MPF mechanism seems to ignore the right of employees to manage their own investment funds. Instead, employers have the right to choose the MPF trustee and scheme. Besides, there are no guaranteed minimum returns on the investment funds offered by MPF trustees. Thus, the MPF system does not achieve its objective as a good way to safeguard the lifestyle of retired employees. Some Hong Kong

citizens even propose abolishing it and replacing it with a full social security assistance system offering complete retirement protection.

The Consumer Council recently released the results of a survey that indicated nearly half of the MPF investment funds recorded a loss in the past five years. In addition, the Council pointed out that the management fees charged by some MPF investment funds are excessively high. The survey added fuel to demands to scrap the MPF system.

Echoing these criticisms about the system, the MPFA has set targets to reform it. The next step after the launch of ECA will be a statutory reduction of MPF management fees. The MPFA has just appointed an independent consultant to study ways to regulate the management fees of MPF trustees (a cap on such fees would be one way to bring them down).

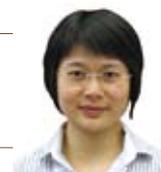
In the end, the MPFA should critically review the MPF system to address the public's concerns. Among other things, it should focus on:

- Proposals to set up a government-run regulator to monitor employee investment funds to guarantee their returns, in order to safeguard retirement income;
- A study of a universal retirement pension scheme to complement the MPF and help those citizens not covered by current retirement protection; and
- Greater flexibility for employees to transfer MPF accrued benefits, such as shorter intervals between transfers, the right to transfer their employer's portion of the benefits, early withdrawal of benefits, etc.

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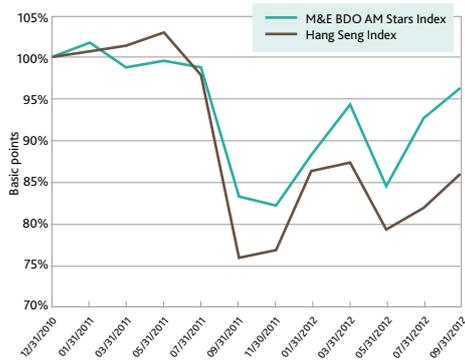
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## INTRODUCING M&E BDO ASIAMONEY STARS INDEX

The M&E BDO Asiamoney Stars Index, a collaborative project by consulting firm Management & Excellence (M&E), accounting firm BDO Hong Kong and Asiamoney magazine, offers an index that tracks companies determined to have good management and strong operations through evaluation of a comprehensive set of corporate data, beyond market capitalisation and share price.

Table 1: M&E BDO Asiamoney Hong Kong Stars Index vs Hang Seng Index



The Index uses the M&E rating method, which quantifies management and processes in four dimensions: verifying compliance with norms and good business practices, monitoring financial and business performance, analysing business strategy and considering the risk of the business.

Close to 350 data points in these four areas were gathered from historical publicly available information to assess each company included in the Index. Examples include revenues and cash flows, declared statements about corporate governance, corporate sustainable responsibility, leadership and business strategy. The companies within the Index will be re-assessed every month, alongside analysis about updates and possible changes to the Index itself.

Hong Kong companies in the M&E BDO Asiamoney Hong Kong Stars Index have consistently outperformed their peers. As for the Index itself, the index value has outperformed the Hang Seng Index's (HSI) by a monthly median of 4.14% from January 2011 until the

end of September 2012, with an outperformance against HSI by 10% in September (Table 1).

For more information about the M&E BDO Asiamoney Stars Index, please contact us via [info@bdo.com.hk](mailto:info@bdo.com.hk)

### Services we provide to listed companies and investors

- ✓ Sustainability and management review & ratings – Detailed strengths/weaknesses profile in allowing for improvement, and more accurately projecting future performance, risk and free cash flow.
- ✓ Return on sustainability – Detailed financial returns /contributions of intangible projects and investments to the current free cash flow, and accurately monitoring and improving project and investment returns.

## NEW CHIEF EXECUTIVE OFFICER AT BDO HONG KONG

Johnson Kong was appointed as the new Chief Executive Officer of BDO Hong Kong, effective 1 October 2012. Johnson joined BDO in 1989 and had been managing the firm's non-assurance practice. He has over 30 years of professional accounting experience specialising in financial investigation, due diligence, litigation support, restructuring and insolvency-related assignments.

Johnson is a Certified Public Accountant (Practising) and a member of the Hong Kong Institute of Certified Public Accountants (HKICPA), the Institute of Chartered Accountants in England and Wales and the Society of Chinese Accountants and Auditors. He is also a member of the Association of Certified Fraud Examiners, a Registered Insolvency Practitioner under the Hong Kong Official Receiver's Panel, and a holder of the Specialist Designation in Insolvency awarded by the HKICPA.

# INTERNAL CONTROL CONSIDERATIONS WHEN A COMPANY PLANS TO BE LISTED

Every private enterprise is funded and managed by one (the owner-manager) or a few major shareholders. As it grows and expands, it needs more capital to satisfy both its daily operational and capital expenditure needs. A listing on the stock exchange is one of the best ways for a company to obtain additional capital and resources. However, if it does so, it may have to face the following issues:

- Its profit will need to be shared with the investment public;
- It will need to comply with listing rules and relevant regulations;
- Its operations will become transparent to the public and be monitored; and
- It will need to implement corporate governance, risk management and internal control systems to protect the interests of its stakeholders.

## Compliance with the Corporate Governance Code

A company that is aiming to become listed (a listing company) should prepare itself to comply with the Corporate Governance Code (the Code) and Corporate Governance Reporting Rules issued by the Hong Kong Stock Exchange (HKEx) after it is listed. The Code contains corporate governance principles and code provisions, as well as recommended best practices. A listed company is required to comply with the Code's provisions, or else explain any deviation from them. It may also decide to adopt some or all the recommended best practices, as it sees fit.

Directors of the listing company are advised to attend training courses to ensure they are adequately equipped with all the necessary knowledge about corporate governance and legal and regulatory requirements.

## Disclosure control mechanism

A listing company is required to make the disclosures required under relevant sections of the HKEx Listing Rules, such as continuing obligation and connected party transaction disclosures. Its disclosure control mechanism therefore has to be effective and ready immediately before it is listed, and it must ensure the required information can be disclosed as and when necessary.

## Establishing a sound control environment

Many entrepreneurs who own private enterprises are businessmen. As such, they tend to focus on business development. Transforming their enterprise into a listed company may require entrepreneurs to emphasise establishing a sound control environment (the cornerstone of an internal control framework) within their organisation, so that they can run its business effectively and be accountable to its stakeholders.

The control environment consists of a number of components. They include ethical value, a code of conduct, risk management philosophy, delegation and limits of authority, internal audit, policies and procedures, and hiring policies. In short, the control environment represents the tone-at-the-top about an organisation's commitment to good corporate governance and risk management practices. It is also a key prerequisite for ensuring the organisation achieves its objectives and goals.

## Listing approach

Sometimes, the method by which it becomes listed has an impact on a listing company's internal control framework. Some typical internal control considerations in different scenarios are shown below.

- **Group of private entities**  
The listing company may consist of a holding company, major operating subsidiaries and/or branches or outlets. The key internal control matters that management should take care of in such a situation include:
  - The establishment of various board committees, such as audit, remuneration, nomination and corporate governance committees, and their respective terms of reference;
  - The early appointment of independent non-executive directors (INEDs), as they can provide valuable input in monitoring the establishment of the company's corporate governance practices;
  - Proper segregation of duties and clear job descriptions;
  - Documented delegation and limits of authority;

- Access controls to the company's assets and IT system;
- Safeguards for the company's assets;
- Anti-fraud controls;
- An effective and independent internal audit function; and
- Documented policies and procedures for key business operations.

- **Spin-offs from an existing listed group**  
A spin-off means the departure of part of an existing listed company and its listing as a separate legal entity. Apart from the above, additional internal control concerns may include the following:
  - Whether a separate management team has been formed to manage the listing company;
  - Whether key operating functions, such as financial reporting, treasury, IT and human resources, have been separated from the existing listed company and are running effectively; and
  - Whether a separate set of policies and procedures has been established and implemented.

## The IPO process

During the IPO process, sponsors are required to conduct comprehensive due diligence concerning the listing company's internal control system, and to make a related declaration under the relevant practice notes (PN) issued by the HKEx. Sponsors may request the listing company to appoint an internal control consultant to assess whether there are any material deficiencies in the company's internal control system. The most common internal control issues are:

<b>Lack of risk awareness</b>	Entrepreneurs sometimes rely on their experience in the decision-making process. Although they are very familiar with the industry, they may not consider relevant risk factors thoroughly when they make decisions, especially those concerning the company's strategies. Also, risk management may not be a standing agenda item during regular management meetings. That means major risk factors affecting the company may be overlooked or not responded to promptly.
<b>Lack of an independent internal audit function</b>	Many companies do not have an independent internal audit function before they are listed. When an audit review is required, such as one concerning major capital expenditure, the management appoints staff from the finance function to conduct it. This approach may constitute a self-review and the results may lack objectivity.
<b>Inadequate policies and procedures</b>	The policy and procedure manual may be principle-based without detailed procedural steps. This makes it difficult for operational staff to understand and implement it.
<b>Inadequate segregation of duties</b>	Lack of risk management knowledge and insufficient resources can often result in the inadequate segregation of duties. For instance, the same person handles cash, records cash transactions and inputs data concerning them into the accounting system. This could lead to misappropriation of assets and affect the integrity of a company's financial reporting.
<b>Conflict of interest</b>	Staff and management are not adequately educated and not aware of the importance of avoiding conflicts of interest. They are sometimes unsure about when potential conflicts of interest should be reported to the appropriate management or Board of Directors.

The PN requires sponsors to play an important role in ensuring the management of the listing company rectifies internal control weaknesses identified before it is listed. In May 2012, the Securities and Futures Commission issued a consultation paper entitled *Consultation Paper on Regulation of Sponsors*. Among the changes it proposed is a requirement that sponsors do not submit a listing application unless the company concerned has remedied its material deficiencies.

In view of this proposal, listing companies are advised to speed up the remediation of their material internal control weaknesses before their sponsors submit a listing application.

Internal control implementation is a continuous process, so the managements of listing companies are responsible for ensuring they have sufficient documentation to demonstrate they are continuously implementing key internal controls and corrective actions during the IPO

process. That will allow their sponsors to feel satisfied they are discharging their duties and responsibilities under the PN.

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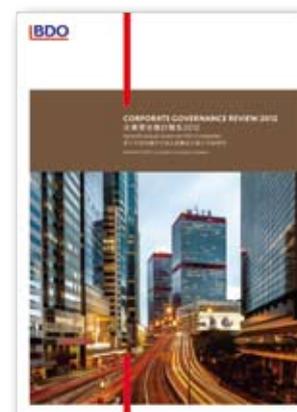
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## CORPORATE GOVERNANCE REVIEW 2012

**B**DO's latest Corporate Governance Review is newly released. It is the seventh year of an extensive annual analysis of the corporate governance practices of the major Hong Kong listed companies. This year a total of 241 Hang Seng Composite Index companies were reviewed.

If you would like to receive a copy of the full report, please visit [www.bdo.com.hk](http://www.bdo.com.hk) or contact us at [info@bdo.com.hk](mailto:info@bdo.com.hk)



## BDO NEW APPOINTMENTS



**KENNETH YEO**  
Director, Head of  
Specialist Advisory

Kenneth Yeo has been appointed as the Head of Specialist Advisory Services since 1 October 2012. He joined BDO in May 2010 and has more than 25 years' experience in providing transaction advisory services to many multinational corporations. His focus includes advising clients on due diligence, financial reviews, IPOs, non-performing loans disposals, capital raising, valuations, restructurings and M&As. He is also a high-profile insolvency practitioner in Hong Kong, and he has acted as the receiver or liquidator in many major corporate collapses. His other work experience includes audit, tax and financial accounting.

He is a Certified Public Accountant in Hong Kong, Australia and Malaysia.



**WILFRED WU**  
Director  
Specialist Advisory  
Services

Wilfred Wu has been appointed as Director after 4 years of service with the firm. He started his career in one of the leading international accounting firms and he has over 15 years' experience in various specialist advisory engagements, including valuations, litigation support, due diligence and corporate restructuring.

He has performed numerous valuation and expert reports for litigation and commercial evaluation purposes, and acted as an expert witness in a white-collar criminal case. He also has solid experience in matrimonial dispute matters.

Wilfred is a Fellow Member of the Hong Kong Institute of Certified Public Accountants.



**JOSEPH HONG**  
Director  
Payroll Services

Joseph has been with the firm for more than 20 years, and was recently appointed as Director. He has extensive experience in accounting and payroll outsourcing services.

He is a Fellow Member of the Association of Chartered Certified Accountants and a Certified Public Accountant in Hong Kong.



**ANTHONY CHAN**  
Principal  
Assurance Services

Anthony Chan was recently promoted as Principal. He has more than 10 years' experience in assurance and financial advisory services. He also has extensive experience in the audit of listed companies and major private companies in different business sectors, including textiles, transportation, software and services, food, metals, household goods and electronics and retailers.

Anthony has had extensive exposure on IPOs as well as M&A exercises in Hong Kong. He is a Certified Public Accountant in Hong Kong.



**ISABELLA AU**  
Principal  
Assurance Services

Isabella Au was recently promoted as Principal. She has extensive experience in handling Hong Kong and Singapore-listed company audit assignments in a wide variety of industries, including manufacturing, property development and agencies, insurance and securities brokers, oil production and schools. She also specialises in transaction support assignments, such as IPOs and financial due diligence in company acquisitions.

Isabella is a Certified Public Accountant in Hong Kong and a Fellow Member of the Association of Chartered Certified Accountants.

# GLOBAL NETWORK DEVELOPMENT AT A GLANCE

## BDO Brazil elected most-admired company 2012

**B**DO Brazil was elected as the most admired company in the Audit, Consulting and Accounting sector in the 10th DCI Awards. The votes were cast by the readers of *DCI*, one of Brazil's leading financial newspapers. On receiving news of the award, the BDO Brazil Board of Directors thanked the 600 employees, clients, partners and friends who voted and helped the firm win the award. BDO Brazil won the award from among three shortlisted companies, and it was presented at the Awards ceremony in November 2012.

## New member firm in Jordan

BDO has appointed a new member firm in Jordan, effective 1 September 2012. The firm provides external and internal audit services, together with a range of tax and management advisory services, including software consulting and forensic services. The firm is expected to achieve a turnover of €1.6 million/JOD 1.4 million during 2012.

## New member firm in Vietnam

BDO has appointed a new member firm in

Vietnam, effective 1 October 2012. More than 150 partners and staff from a number of Vietnam firms (including the PKF member firm in Hanoi) have agreed to form a new BDO Member Firm there, with offices in Hanoi and Ho Chi Minh City. This will effectively expand BDO's service offerings in Vietnam to encompass a full range of audit, advisory and tax services provided by a team of highly-regarded industry professionals. The firm aims to become one of the top six in Vietnam.

## BDO continues to strengthen presence in Australia

Following the integration with PKF's Australian East Coast Practice in August 2012, the BDO Member Firm in Australia has confirmed the completion of merger negotiations between the Adelaide member firm, BDO (SA) Pty Ltd, and PKF Business Advisers Pty Ltd in Adelaide. The merger brings together the BDO and PKF offices in South Australia under the BDO brand.

BDO's Australian National Chairman Tony Schiffmann comments: "The previous integration of BDO and PKF ECP has been very successful. Now, the merger between BDO and

PKF in Adelaide means we can further support our clients by providing a greater range of solutions, backed by expanded technical and industry sector expertise."

The merger was completed 1 January 2013. The combined firm will increase its headcount to 25 partners and around 180 staff, and its turnover to around A\$25m. This will further bolster BDO's position in Australia, where it is expected to achieve revenues in excess of A\$250m during the 2013 financial year.

## BDO and PKF in merger discussions

BDO LLP and PKF (UK) LLP have announced they are in advanced discussions to merge in early 2013. The merger will create a leading accountancy and advisory firm with some 3,500 people in the UK generating revenues approaching £400 million. This will be the first proactive strategic merger in the UK accountancy sector for 15 years, and it reflects both firms' sustained commitment to growth in their mid-market heartland. The merged firm will be uniquely placed to offer greater choice and quality.

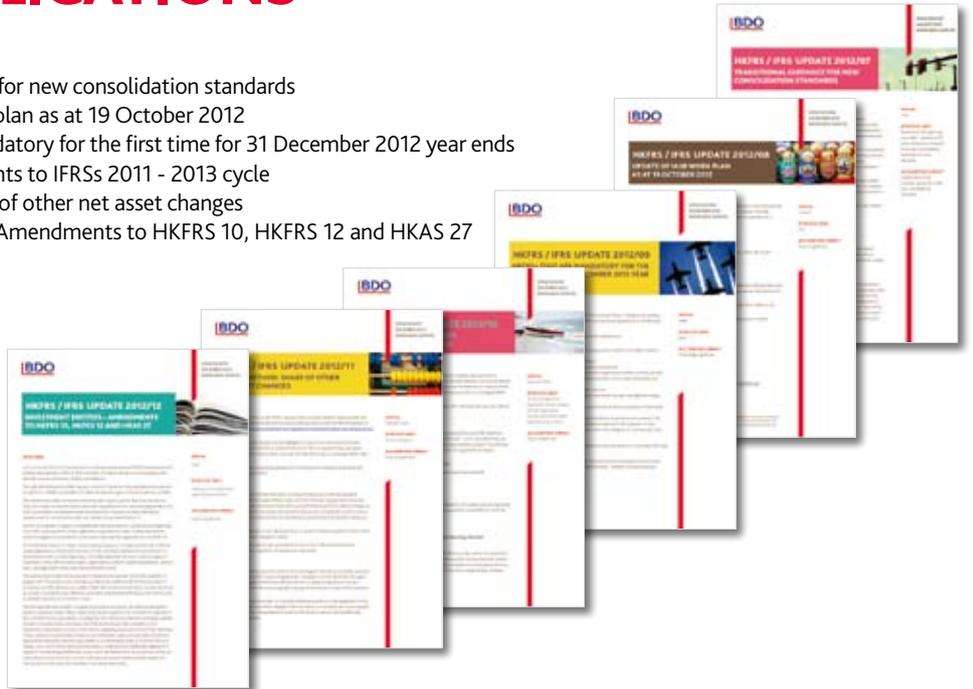
## RECENT BDO PUBLICATIONS

### HKFRS / IFRS UPDATES

- HKFRS/IFRS Update 2012/07: Transitional guidance for new consolidation standards
- HKFRS/IFRS Update 2012/08: Update of IASB work plan as at 19 October 2012
- HKFRS/IFRS Update 2012/09: HKFRSs that are mandatory for the first time for 31 December 2012 year ends
- HKFRS/IFRS Update 2012/10: Proposed improvements to IFRSs 2011 - 2013 cycle
- HKFRS/IFRS Update 2012/11: Equity method: share of other net asset changes
- HKFRS/IFRS Update 2012/12: Investment entities – Amendments to HKFRS 10, HKFRS 12 and HKAS 27

### RISKY TIMES

Corporate directors: Heightened expectations



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