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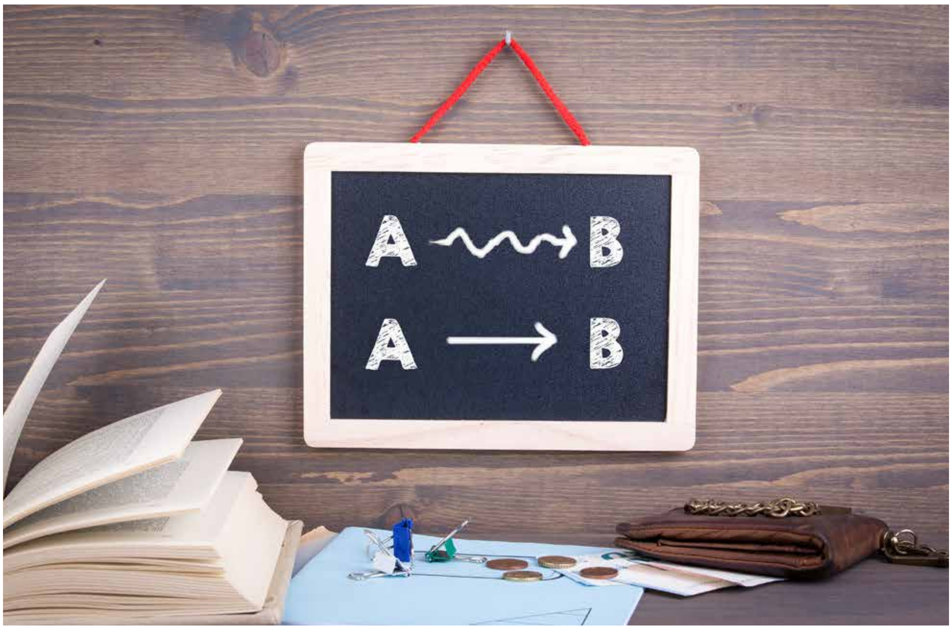
WHAT WILL MATTER TO ENTREPRENEURS WHEN THE PROPOSALS FROM THE CHIEF EXECUTIVE'S 2017 POLICY ADDRESS TAKE EFFECT?



The Chief Executive, Carrie Lam Cheng Yuet-ngor, delivered her first policy address on 11 October, in which she announced a number of proposals to address the economic, social and political issues of concern to the Hong Kong community, setting out her vision for maintaining the city's global competitiveness.

Mrs Lam outlined her proposals for various sectors, covering the introduction of measures to boost economic development, an increase in land and housing supply, and increased spending on research and development (R&D), as well as innovation and technology promotion, measures to improve the livelihoods of elderly people and low-income families, youth development, and many more.

Among all these proposals, there are several that will affect Hong Kong employers and SMEs in 2018 and beyond. **Table 1 & 2** outline details of the relevant proposals.

The proposal to stop allowing employers to offset SPs/LSPs against their MPF contributions for employees has been a long-awaited request from Hong Kong employees since the beginning of the term of office of former Chief Executive, CY Leung.

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Table 1
Proposals for increasing employees' benefits and rights

Highlights	Action plan	Target timeframe for formulating the proposals
1. Abolition of the rules that allow employers to offset Severance Payments (SPs) or Long Service Payments (LSPs) against employers' Mandatory Provident Fund (MPF) contributions for employees	The Government will increase its financial commitment to mitigating the impact of the abolition of the offsetting mechanism. The Government will continue discussions with the business and labour sectors with a view to coming up with a proposal that can balance the interests of both employers and employees.	To be announced in the coming months.
2. Proposal to increase statutory paternity leave benefits	• Initiation of a proposal to increase statutory paternity leave from the current three (3) days to five (5) days. • The daily rate for statutory paternity leave would remain unchanged (ie the equivalent to four-fifths of the employee's average daily wage).	To be announced by the Labour Department at a later date.
3. Proposal to enhance statutory maternity leave benefits	Commencement of a study and work on enhancing the current statutory maternity leave benefits.	To be announced by the Labour Department at a later date (it is anticipated that the enhanced maternity leave plan would take around three years to formulate).

Table 2
Proposals for tax relief and mega tax reduction on investment in R&D expenditure

Highlights	Action plan	Target timeframe for formulating the proposals
1. Implementation of the two-tier Profits Tax plan	• Profits Tax rate for the first HK$2 million of profits to be lowered to 8.25% (for unincorporated businesses: 7%); and • Profits exceeding HK$2 million will continue to be taxed at the current standard Profits Tax rate at 16.5% (for unincorporated businesses: 15%), if applicable. • Please refer to below note on relevant restrictions.	To be implemented in fiscal year 2018/19 (subject to further announcements by the Inland Revenue Department).
2. Mega tax reductions for companies that invest in R&D expenditure	• For the first HK$2 million investment in R&D expenditure, companies can get a 300% tax deduction. • For R&D expenditure exceeding HK$2 million, there will be a 200% tax deduction.	To be implemented in fiscal year 2018/19 (subject to further announcements by the Inland Revenue Department).

Note: Only one firm within a group of enterprises can benefit from the lower tax rate as a measure to restrict abuse of such tax relief arrangements.

Before Mr Leung's term ended in June 2017, he made a proposal to ban the offsetting mechanism by reducing the proportion of an employee's monthly wages as the basis of calculating SPs/LSPs from two-thirds of a month's wages to just half (50%), as compensation for each year of service. He also suggested that such an offsetting arrangement would not apply retrospectively and that a sum of HK$7.9 million should be reserved to subsidise SME entrepreneurs for their additional expenditure on SPs/LSPs for the 10 years following the ban of the offsetting arrangement. However, as expected, Leung's suggestions met with opposition, since both the labour and business sectors were unhappy with them; employees would receive a significantly lower amount of SPs/LSPs, while employers would incur additional operating costs.

Mr Leung has now completed his term of office and handed responsibility to Mrs Lam. If Mrs Lam decides to help stakeholders to reach a consensus on this controversial issue and eventually abolish the offsetting mechanism as she promised, she may need to start thinking outside the box.

From the employee's perspective, the above proposals to increase benefits and rights are welcome. However, except for the proposal to increase statutory paternity leave to five days, which legislative amendment would make relatively uncomplicated, it is expected that the other two proposals would take longer, with studies and discussions on the complexity and controversy surrounding these topics required before the government can proceed further with such legislative amendments.

SME entrepreneurs stand to benefit from the tax relief and/or tax reduction of investment in R&D expenditure when the above proposals take effect. On the other hand, these tax relief and/or tax reduction benefits would be diluted by the increase in employers' operating costs, due to the abolition of the SPs/LSPs offsetting mechanism and an increase in paternity leave and maternity leave benefits for employees.

In view of the impact of the above proposals on various stakeholders, and the need for further studies and discussions between the stakeholders involved before some of these proposals can undergo legislative changes, we will keep readers of APERCU informed about the latest developments.

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BDO'S POSITION AS LEADING ADVISER TO THE MID-MARKET IS REINFORCED AS GLOBAL REVENUES SURPASS THE US$8 BILLION MARK AND HEADCOUNT INCREASES BY 9%

BDO is pleased to announce a total combined fee income for the year ended 30 September 2017 of US$ 8.1 billion / € 7.4 billion*. This represents a year on year growth of 8%, at constant exchange rates. **including BDO's exclusive Alliances.*

BDO's global representation continues to steadily expand, up from 158 countries and territories in 2016 to 162, thus ensuring a fit with clients' global locations. Global headcount has increased by 9.04%, with 73,854 people now working out of 1,500 BDO offices worldwide.

BDO identifies the following among the reasons that have contributed to this tangible growth:

- **Digital transformation** – BDO understands that real value comes from helping our clients through innovation and change: technology is transforming the profession and data analytics, big data, benchmarking and insight tools are a big focus. In 2017, BDO has augmented its digital transformation activities to meet the automation challenges of the future, including robotic process automation, blockchain and bot technology. The organisation continues to leverage its long-time partnerships with market leaders such as Microsoft and Xero, and ensures that its bespoke Audit Process Tool is meeting the challenges of the future.

- **Engaged clients** - In a world driven by technology, investment in the digitisation of services allows BDO to offer greater added value to clients. The infrastructure and resources available to all BDO firms include a range of client engagement platforms and world class methodologies, enabling a globally consistent service delivery. In this way, BDO provides a digital client experience at both service line and firm level, empowering BDO firms to not only carry out better audit and tax operations for their clients, but also to respond faster to client opportunities. This ability to be both agile and responsive helps BDO's experts to build relationships with their clients that are based on trust – an approach that demonstrably works, as the network has achieved a number of important wins in the last year, both in larger firms such as Germany, the UK and the US and in smaller ones, including BDO India and BDO UAE.

* Statistics as of 30 September 2017

- **Merger activity and new firms** - BDO welcomed new firms in Antigua & Barbuda, Dominica, Grenada and Samoa in 2017, as well as a replacement for the former BDO firm in Aruba. The year also saw a series of high-exposure mergers across all regions, including Armenia, Finland, France, Ireland, Italy, Luxembourg, South Africa and Spain in EMEA, and Australia, India and Indonesia in Asia Pacific. Revenues in the region as whole grew by 5.1%, where BDO India stands out as a result of its aggressive growth strategy, in which its partnership base has increased from 20 to 67 in the last 18 months alone, including numerous lateral hires from the competition.

The year-on-year revenue increase in the Americas was 9.6%, where the new firms in Eastern Caribbean were as a result of the BDO firm's merger with the former KPMG practice, bringing new partners to BDO St Lucia and a replacement firm in St Vincent & the Grenadines. BDO Puerto Rico completed the island's largest ever merger in January, taking them to number 1 in that territory. The region also saw significant mergers in Brazil, Canada and the USA.

BDO HONG KONG MANAGING DIRECTOR – NON-ASSURANCE JOHNSON KONG WAS ELECTED AS THE NEW VICE PRESIDENT FOR HKICPA

BDO Hong Kong Managing Director - Non-Assurance, Johnson Kong was elected as the new Vice President for the Hong Kong Institute of Certified Public Accountants (HKICPA) at its 577th (Special) Council Meeting held on 14 December 2017.

Johnson is an elected HKICPA Council Member. Amongst others, he is the Chairman its Qualifications Oversight Board and Professional Conduct Committee, Deputy Chairman of Small and Medium Practitioners Committee and member of the 7th Long Range Planning Steering Group. He is also a Past Chairman of the Restructuring & Insolvency Faculty of HKICPA, Past President of the Hong Kong Institute of Accredited Accounting Technicians and an Ex-Executive Board Member of INSOL. In addition, he has recently been appointed by the International Federation of Accountants (IFAC) as a member of its Small & Medium Practices Committee.

GLOBAL RISK LANDSCAPE 2017 – DEALING WITH CHANGING RISKS

In early 2017, BDO's Global Risk Landscape survey gathered qualitative insights from 500 C-suite and senior level experts from 55 countries across Europe, the Middle East, Africa, Asia and America in order to obtain their views on the main risks their businesses are facing, now and in the future. The objective of the survey was to gauge the perception of risk amongst business leaders around the globe. The results of this year's survey report capture perceptions of risk at a unique point in time when there is increasing evidence of regional similarities in a globalised and interconnected world.

Top three current threats

Of those who responded to the survey, 72% said they believe that global risks have increased. While this is still a significant proportion of respondents, it is nevertheless a significant drop from the 87% who believed that global risks had increased in the 2016 survey.

This reduction could signify increased confidence in the macroeconomic and geopolitical environment and reflect the below-average number of major natural disasters and man-made catastrophes in 2016. It may also reflect improvements in governance, risk management and business continuity planning.

However, given the backdrop of political, social and economic upheaval over the last 12 months and the startling evidence of how quickly brand value can take a beating in a world where news travels fast and public perception is less and less forgiving, the top three threats to overcome are as follows:

1. Regulatory risk
2. Increasing competition
3. Economic slowdown/slow recovery

More similarities than differences among regions

In **Figure 1**, the regional landscape looks fairly similar. Business leaders across Europe, the Middle East and Africa (EMEA), Asia Pacific (APAC) and the Americas all agree on the top three threats for 2017. These increasing similarities between regions and sectors could reflect the realities of a globalised and interconnected world, where macro trends are central to risk forecasts.

Looking further ahead, the top two threats are also consistent across the three broad regions: business leaders have identified that people and damage to their reputation or brand will become more prominent challenges. All regions believe risk to be increasing at a manageable rate. This shows that on the global stage there are now more similarities than differences among regions.

Risks that businesses are least prepared for

Of the emerging risks, these are the ones that could catch businesses unawares. The key risk themes faced by business leaders around the globe are as follows:

1. Macro risks
2. Disruptive technologies
3. Regulatory and governance.

Macro risks

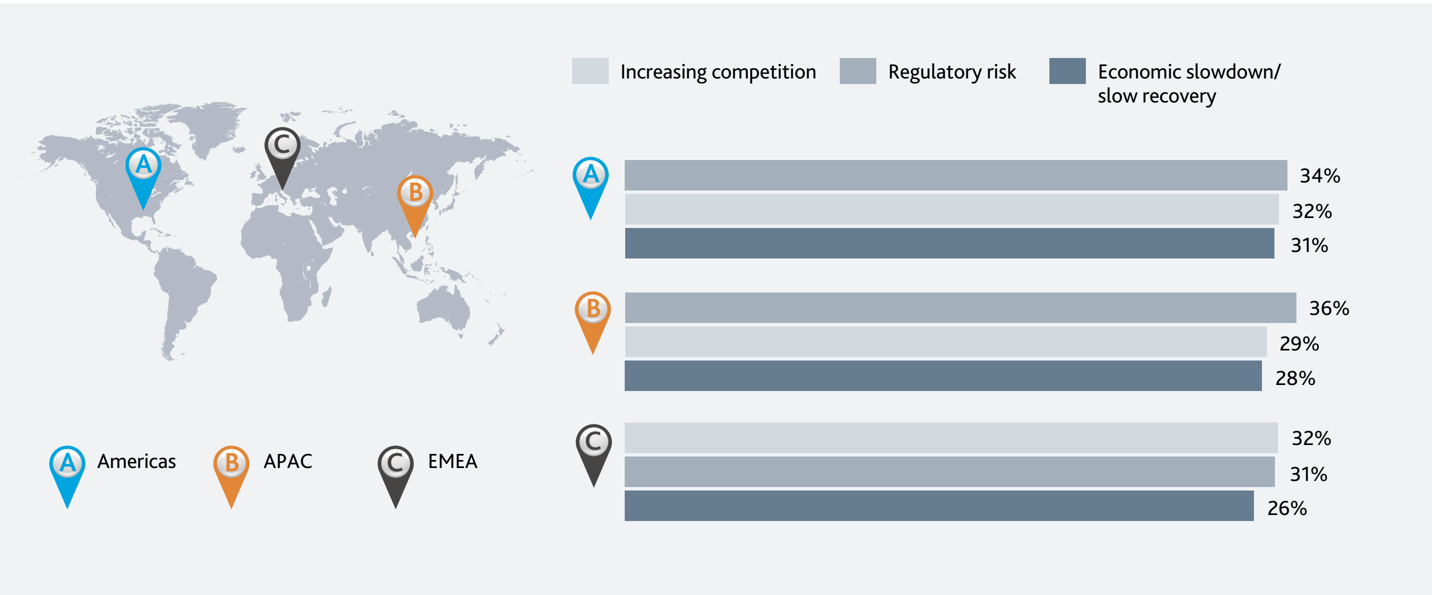
Looking at the wider context, there are three major macro risks that people need to be aware of: **geopolitical risks**, **supply-chain deficiencies** and **talent shortages**.

Most of the respondents felt that geopolitical risks would have a strong impact on their business. Following the political earthquakes of 2016, geopolitical risks have shot up in our rankings: they are now a top-three macro concern for businesses, whereas last year they featured in seventh place.

However, it was anticipated that 2017 was not likely to be an easy ride. The geopolitical situation in Germany, the US, Turkey and China is uncertain. Added to this is the situation regarding ISIS, the so-called Islamic State. Shifts in government and changes in regulation and trade will continue to impact our businesses. We will be watching closely to see how these events unfold, and we will certainly be keeping geopolitical risks front of mind for the year ahead.

Indeed, geopolitical change has the most obvious impact on supply chains. For this reason, supply chain vulnerability is an increasing macro concern for many of our respondents. Few supply chains are confined to one country any longer: there has been

Figure 1: Top three threats faced by regions



a dramatic shift away from 'local for local' manufacturing, and what a supply chain is and does has evolved. Supply chains now deal with services, people and finance as well as raw materials, components and finished goods. The 2016 Business Continuity Institute's *Supply Chain Resilience Report* stated that 66% of companies do not have full visibility of their supply chains. A supply chain that crosses borders and continents becomes exposed to all the variables that generate risk, including the political environment, cultural challenges, quality challenges and regulatory issues. This lack of visibility is a key risk.

More than half of the employers surveyed said that talent shortages could have a "seriously negative" impact on their business, with consequences such as reduced competitiveness, lower productivity, higher employee turnover and lower morale.

The financial crisis and the resulting recruitment freeze have led to high levels of youth unemployment around the world. In addition, the shift towards offshoring and automation means that career progression paths are being lost.

Of the survey respondents, 76% said the market for skilled talent will become smaller and that talent will become more expensive. However, there is little consensus on who is responsible for overcoming these challenges. Of the respondents, 58% believe this is up to the senior management, while 28% believe it is part of the function of human resources.

Setting out clear roles and responsibilities and working holistically are key to tackling talent shortages.

Disruptive technologies
Technology is one of the respondents' central concerns. Throughout the survey, there is recognition that the digital data-driven age will be both a major challenge and an opportunity for businesses across all sectors as we move forward. Roughly 40% of all sector respondents felt that disruptive technologies are their biggest emerging business risk. In addition, 85% felt that the evolution of technology is the threat they are most unprepared for. It is clear that in an increasingly competitive environment, the ability to adapt, to embrace change, to invest in the right technologies and to leverage the right data will separate the winners from the losers.

The data threat is one of the main reasons companies are not adopting new technology. Of chief risk officers who responded to the Survey, 75% are concerned about how cyber exposures could affect their business. Almost 70% said that security concerns had delayed the adoption of public cloud computing by a year or more. A serious attack detracts from the value of putting in place new IT infrastructure and could cripple an organisation's reputation.

One solution that can reduce the impact of cyber threats is to address action with new regulation: the General Data Protection Regulation (GDPR), which comes into force in May 2018, sets out new standards for maintaining the privacy of individuals' personal data within the European Union and allows for the levying of fines of up to 4% of global turnover for organisations that do not comply. Data theft through a successful cyberattack is one of the main potential sources of a breach of data privacy; therefore, this increases the importance of the need for effective cyber security and regulation.

Regulation and governance
Last but not least, more than 34% of those we surveyed highlighted regulation as their biggest challenge at the moment. Europe, the Asia Pacific region and the Americas felt that they were the most at risk over the next decade.

Most concerning to our respondents is the higher cost of compliance. Close to half (41%) of the groups participating in the survey said they believe the spate of new regulations on the horizon will increase the cost of doing business.

With this in mind, is there anything we can be doing to manage ongoing regulatory change?

- First, we recommend engaging with the regulators to stay informed and understand how potential changes might affect your existing business practices.
- Second, stay flexible. The more easily you and your company can adapt to change, the less impact modifications are likely to have on your business.
- Third, keep leadership involved and get them to talk to people at the coal face.

If you have any questions, please contact the author below.

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THE INAUGURAL BDO ESG AWARDS

To recognise the efforts and positive impact contributed by Hong Kong-listed companies in the areas of Environment, Social and Governance (ESG), BDO is organising the inaugural BDO ESG Awards, with the presentation ceremony to be held in Hong Kong on 25 January 2018. The Awards aim to encourage companies to be more aware of their social responsibility to incorporate sustainability into their business model.

BDO ESG AWARDS
環境、社會及管治大獎 2018

The top three companies from each of the large market capitalisation, middle market capitalisation and small market capitalisation of Main Board companies as well as companies from the Growth Enterprise Market will be selected as winners in each of the three award categories: (1) Best in ESG Awards; (2) Best in Reporting Awards; and (3) ESG Report of the Year Awards. For details, visit: http://www.bdoesgawards.com

Organiser: BDO

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DIGITALISATION TRENDS IN BUSINESS PROCESS OUTSOURCING (BPO) – PART 1

Information technology is present in every aspect of our daily lives, including shopping, banking, travelling, and much more. In a business environment, the use of information technology is critical to the management of business activities.

Technology has been proven to enable convenience, speed, and accuracy, and it also enhances communications. It has opened up a whole new world to us, and has made outsourcing a more feasible and workable option for businesses.

How does transformation lead to outsourcing?

The role of professionals in an organisation has begun to evolve from the standard triangle (**Figure 1**) to an inverted triangle (**Figure 2**). The inverted triangle shows that professionals will spend most of their time, effort, and resources on strategic planning and decisions. Their role in an organisation is no longer functional, but transformational. The inverted triangle is an inevitable trend, now and in the near future. This transformation can be achieved by outsourcing administrative and operational processes, by automating specific repetitive processes, or by doing both.

Key benefits of outsourcing and how it facilitates the transformation of a professional's role

1. **Scalable and flexible** – Using a third-party provider allows you to scale up or scale down their services with flexibility, rather than hosting everything in-house and making changes on an ongoing basis.
2. **Expertise** – You are putting your work in the hands of trained professionals whose sole focus and responsibility is to deliver quality and value-added services to you.
3. **Improving focus** – By outsourcing, businesses can devote more of their own people and resources to their core mission.
4. **Enhancing accuracy, quality and compliance** – The mission of outsourcing service providers is to help their clients make continuous improvements in accuracy, quality and compliance through established processes of review and approval, in addition to keeping up to date on statutory and compliance requirements.
5. **Reduced costs** – In the long run, outsourcing helps to reduce costs in the following ways:
   - Economies of scale
   - Minimising non-compliance costs
   - Minimising change management costs, such as investment in technology and updates.
6. **Advanced technology** – A digitally well-equipped outsourcing service provider can further enhance their clients' operational efficiencies and user experiences by offering advanced technology to clients.
7. **Better user experience** – This leads to a happier team and higher staff retention.

Please stay tuned for the next issue of APERCU. We'll be sharing our observations on the evolution of outsourcing, and how BDO has responded to change during our more than three and a half decades of providing professional services in the BPO servicing industry.

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Figure 1

Figure 2

BDO HONG KONG WON THE GOLD AWARD

BDO Hong Kong has recently been crowned as the Gold Award Winner of the Best Payroll Outsourcing Partner of the HR Vendors of the Year Awards 2017.

The Awards are judged by an extensive panel of 13 judges, including senior HR professionals, VPs and Directors from large multinational companies like H&M, Jardine Matheson, Ferragamo, and etc. Winning the Award represents the industry's recognition of our great service quality and professionalism. This is the first time that we entered into this competition, we are proud that we have managed to outperform the other four finalists being shortlisted from numerous contestants to the Award.

We strongly believe that our ability to win this award was due to our high level of professionalism, dedication to service quality, innovation as well as our willingness to invest in technology and tools/measures to safeguard system and data security. Further, we were able to demonstrate ourselves as the pioneer in the industry and market, with our ability to provide comprehensive online HR solution (Valise – an employee self-service platform) for our clients to use. With all these winning elements armed with our firm's comprehensive service offerings, BDO network's significant global footprint, as well as the awards won by the Global Payroll Team in the recent years, we have been chosen to be the winning firm.

ESTIMATING EXPECTED CREDIT LOSS UNDER IFRS 9

The global over-the-counter (OTC) derivatives market has grown significantly over the last two decades. According to the Bank of International Settlement, the notional outstanding value of global OTC derivatives was approximately US$94,037bn in 2000. This value has increased 5.8 times to US$544,052bn in 2016. This global increase is a consequence of more and more market participants engaging in derivatives trading due to the following reasons.

1. Margin trading allows investors, hedgers and speculators to purchase OTC derivatives by borrowing a portion of money from brokers, therefore increasing the potential gains.
2. The OTC market allows the inclusion of specific features tailored by both sides of the deal.
3. Access to OTC markets is easier, and for end users the trading of OTC derivatives is cheaper than exchange-traded derivatives.

However, transparency and regulation in the OTC market has not kept pace with the increase in trading volumes and the diversification of product types. This has led to wide-ranging and interconnected risk exposure among market participants, in addition to the risk of higher volatility. During the financial crisis of 2008, the high delinquency rates of residential mortgages led to the devaluation of some OTC derivative products, especially mortgage-backed securities. The owners of these assets, such as banks, which invested heavily, suffered extensively from a drop in value and lack of liquidity in the market. The ramifications of the associated events have been documented comprehensively and need no further explanation. However, the global financial crisis of 2008 did show policymakers, regulators and market participants that no business was completely protected from or immune to credit risk. Even those businesses with high credit ratings, which would previously have been deemed as "too big to fail", were under the spotlight.

Because of the significant losses suffered by financial institutions and investors during the financial crisis, the management of credit risk has become a hot topic in the banking, investment and accounting community. A common definition of credit risk is "the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation"[1]. With the increasing connectivity of the global financial markets and an increase in the types and trading volumes of more complex OTC derivatives, the enforcement of a more consistent, comprehensive and stringent credit-management assessment has become paramount. The International Accounting Standards Board (IASB) began the process of updating International Accounting Standards 39, "Financial Instruments: Recognition and Measurement" (IAS 39), in order to clarify and reconcile the accounting treatment of different types of financial assets and to monitor credit risk more closely in a forward-looking manner. In July 2014, IASB published a complete version of International Financial Reporting Standards 9, "Financial Instruments" (IFRS 9), which will replace IAS 39 and become effective for the accounting periods from 1 January 2018.

Table 1: Key differences between IAS 39 and IFRS 9[2]

	IAS 39	IFRS 9
Classification and measurement	Four categories: 1. Held to maturity 2. Loans and receivables 3. Fair value through profit and loss (FVTPL) 4. Available-for-sale.	Three categories: 1. Amortised cost 2. Fair value through other comprehensive income (FVOCI) 3. Fair value through profit or loss (FVTPL).
	Classification basis: Specific definitions for each category.	Classification basis: Contractual cash-flow characteristics and entity's business model.
	Allow financial asset host contract and equity investments to be measured by cost.	All derivative liabilities and equity investments should be measured by FVTPL.
	Complex rules for reclassifications.	Reclassification only when the business model for managing financial assets changes.
Impairment	Different impairment models for different types of financial assets, with losses being recognised when a credit event occurs.	Uniform impairment model, with losses being recognised on first recognition and in each subsequent reporting period.

In accordance with IFRS 9, the expected credit loss of a financial asset should be valued when the loss is first recognised and in each subsequent reporting period, not just when a credit event occurs. As such, the enforcement of IFRS 9 undoubtedly sets higher requirements for the knowledge and financial modelling skills of a company's management and its auditors. It will also pose a new challenge to management: to develop a new system to assess credit risk that satisfies the requirements of the new standard. The key differences between IAS 39 and IFRS 9 are summarised in **table 1**.

12-month vs lifetime expected credit loss (ECL)

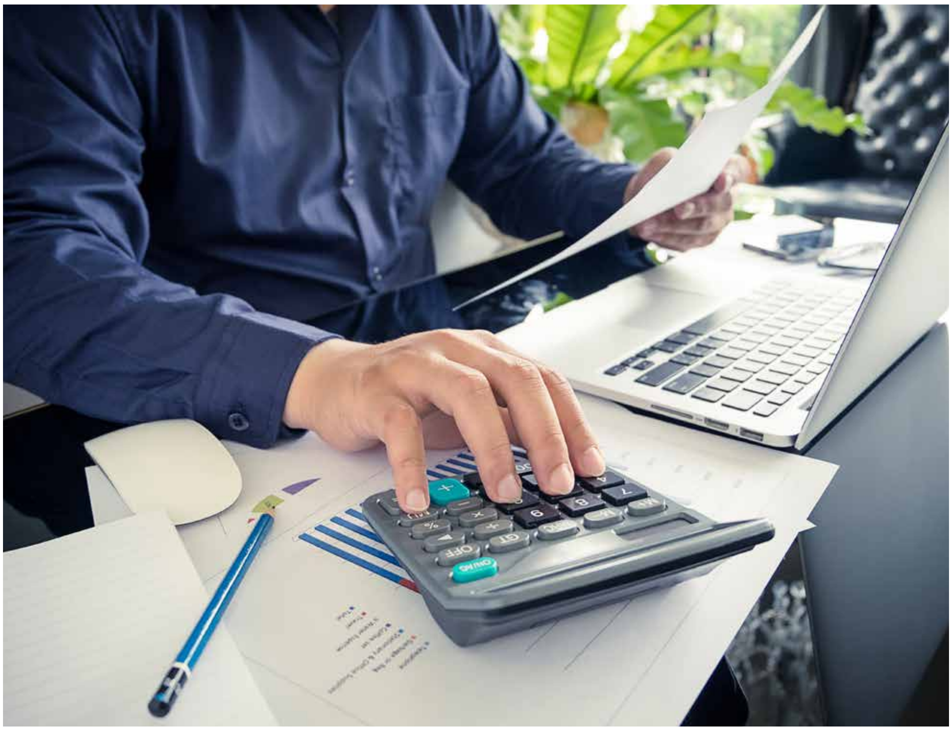
Under a three-stage approach presented in IFRS 9, if the credit risk of a financial asset is low on the reporting date (Stage 1), the credit loss should be derived using a 12-month ECL. If there is a significant increase in credit risk between its first recognition and the relevant reporting period (Stage 2) or if a financial asset was purchased or originated as a credit-impaired asset (Stage 3), the lifetime ECL should be assessed.

IFRS 9 requires that an effective assessment system for credit risk must reflect the following three pieces of qualitative and quantitative information.

1. An unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes.
2. The time value of money.
3. Reasonable and supportable information about past events, current conditions and forecasts of future events and economic conditions at the reporting date.

At this point, IFRS 9 neither specifies nor recommends any specific methodology to measure the 12-month or lifetime ECL. It does

1. International Financial Reporting Standards (IFRS) – 7 Financial Instruments Disclosure, Appendix A defined terms.
2. We recommend reading the full versions of IAS 39 and IFRS 9 in order to understand the differences and their impact on financial statements.



not provide any detailed steps for deriving the parameters of any one selected approach.

Measurement methodology

A straightforward and commonly applied approach to valuing the ECL under IFRS 9 is a probability-weighted loss default (PLD) model. The PLD model involves the following four key parameters.

1. **Probability of default (PD)**, which is the likelihood of a counterparty default (failure to meet repayment/debt obligations) during a particular period of time.
2. **Loss given default (LGD)**, which is the percentage of contractual claims that would be lost if the counterparty defaults.
3. **Exposure at default (EAD)**, which is the total value that one entity is exposed to when a counterparty defaults; for example, for a two-year loan contract with a face value of HK$1m and a coupon rate of 5% per annum, the EAD for the bondholder at the first anniversary and the second anniversary would be HK$1.05m and HK$1.05m for each year.
4. **Discount factor (DF)**, which is the factor that needs to be multiplied in order to convert future cash flows into the present value at the measurement date.

In this model, the ECL is derived by totalling the ECL of all the expected default events within a specific period (either 12 months or a lifetime). The ECL for each possible event is calculated as the product of the four parameters mentioned above, according to the formula shown below:

$$ECL = \sum_{i=1}^{T} DF(t_i) * PD(t_i) * PGD(t_i) * EAD(t_i)$$

Under IFRS 9, the ECL can be valued at an individual level or at a collective level if it is possible to classify the financial assets into different groups based on their credit risk characteristics. For example, credit-risk rating, remaining life, industry of issuer, denominated currency, and collateral type.

Implementation of IFRS 9

There are several practical difficulties in the implementation of an ECL model under IFRS 9. These vary significantly depending on the distinguishing characteristics of the type and complexity of the financial asset. Financial assets are becoming more sophisticated as investors and issuers include new features to protect their interests during the negotiation process. We will mention one or two of the potential difficulties below.

The time cost of implementing this new standard is a major concern. To establish an appropriate and feasible system for assessing credit loss, financial models should be compared by weighting the accuracy of each model's outcomes and the time cost to be spent in constructing the model, testing it and identifying errors.

Many financial derivatives (ie, convertible bonds, promissory notes, preferred shares and callable and puttable bonds) issued by Hong-Kong-listed companies for refinancing or funding acquisition purposes are not freely traded on exchanges or in OTC markets. Therefore, there is no trading record and there are no reliable historical statistics. The historical statistics are used to make more accurate forecasts for the following: the default probability of the issuers; the default value of financial derivatives with a similar level of seniority; and the refund amount if default ever occurred. Under these circumstances, with no historical data, building an ECL model would rely heavily on professional judgement and the market practice of management and auditors, based on their previous knowledge and experience.

Conclusion

The implementation of IFRS 9 will help to create a more effective system for assessing credit risk among various market participants. However, the creation of the ECL model will require the appropriate skills and knowledge. Managers and market participants should be proactive and seek advice from professionals with the appropriate skills and knowledge. This is especially important before confirming financial derivative contract terms. Professional advice will greatly reduce corporate compliance risk and decrease the likelihood of estimation biases in the reporting of financial assets. It will also provide integral insight at the portfolio level into monitoring and managing credit risks in your financial statements.

How BDO can help

BDO has a dedicated advisory and valuation team that is made up of highly qualified individuals. We have in-house experts in the valuation of various financial instruments, and they have a deep understanding of the requirements and application of IFRS 9. We can help you with the following:

- Building and reviewing an ECL model
- Valuing ECL at a standalone asset level or at a portfolio level
- Advising on the scheme and structure of financial instruments
- Advising on the accounting treatment
- Measuring the profit-and-loss impact according to a scenario analysis
- Advising on a risk-management system
- Formulating effective hedging solutions.

If you have any questions, please contact one of the authors below or your usual BDO contact.

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BDO SURVEY: REVIEW ON ESG REPORT COMPILATION BY HONG KONG-LISTED COMPANIES

Over the years, the total number of mandatory environmental, social and governance (ESG) reporting requirements have grown rapidly worldwide. It is very clear that ESG issues are global market concerns. From 1 January 2016, every listed company in Hong Kong must disclose its ESG information on an annual basis. Following BDO's ESG Reporting Performance Survey announced in July 2017, BDO has conducted a second survey and reviewed the compilation process of the ESG reports from 68 companies listed on the Main Board and GEM and based in Hong Kong. The aim of the survey was to better understand the challenges and gain feedback about ESG reporting practices after the implementation of this regulation. Of the 68 companies surveyed:

- 80% believe that the ESG report enables better internal control and risk management or enhances the investment value of the company;
- 60% of companies have invested additional resources, and 88% of these have hired an external consultant;
- all see the benefits from issuing an ESG report, but 54% have no plans to increase the budget for ESG reporting in the coming year;
- most small- and mid-cap companies spent HK$100,000 or less when preparing for the ESG report;
- collecting data and analysis from subsidiaries is the most difficult challenge when preparing this year's ESG report, according to 62% of respondents; and lack of resources is the second most difficult challenge, according to 32% of respondents;
- 70% said that collecting and analysing new compulsory data disclosure is their largest concern in preparing for next year's ESG report; and
- more than half disagreed that the ESG report could mitigate the negative impact of malicious market rumours or attacks on the company.

BDO recommends that companies take the following measures to make compiling the ESG report easier:

1. **Data collection made easy**
   It is understood that some of the listed companies are entities within the same group. By establishing **a centralised ESG function or team**, resources can be better utilised to handle the collection of ESG data from different group entities in a consistent and efficient manner. Besides, we suggest that listed companies seek assistance from consultants to establish a data-collection template so that a consistent approach is taken to collecting data (unless there are significant changes in operation).

2. **Derive ESG value from reducing the company's carbon footprint**
   Small- and mid-cap companies often face the challenge of limited resources for operations and business expansion. Tightened regulatory and disclosure requirements divert resources even further. The results of our earlier ESG survey showed that some listed companies have achieved cost-savings by reducing their carbon footprint; for example, by using energy-efficient equipment. We suggest that small- and mid-cap companies consider starting to implement ESG practices with **small pilot projects**, such as replacing the lighting system with an energy-efficient one, streamlining logistics and transportation practices, evaluating patterns of equipment use, implementing paperless operations, and so on.

3. **Enhance operational efficiency by engaging suppliers**
   Supply chain management is important to every business organisation. Hiccups or breakdowns in the supply chain may lead to temporary stoppage of production, failure to fulfil customers' orders, and so on. We suggest that listed companies conduct a comprehensive **supply chain risk assessment** and identify events that could trigger a supply chain breakdown. The management should then engage with relevant vendors to formulate strategies to mitigate possible risk factors, streamline supply chain procedures, identify alternatives, routinely obtain feedback from suppliers, and so on.

4. **Constantly revisit ESG practice and strategy**
   Having experienced the first year of reporting, listed companies have gained basic knowledge of ESG reporting and may have identified the direction and goals that ESG practices should strive to follow and achieve. We suggest that listed companies should always be aware of the **most up-to-date good practice in ESG and energy-saving technologies**, as well as the options to enhance and refine their ESG strategy.

BDO HONG KONG NEW APPOINTMENT

HONG NG
Director and Head of Operations & Finance

Hong Ng, previously Managing Director of Risk Management is now appointed as Director and Head of Operations & Finance. With his continuance as an Assurance Director, he also oversees Finance (FIN), Human Resources (HRD), Office Administration (ADM) and IT Support (ITS) departments.

Hong has over 30 years of experience in the accountancy profession. He is a Fellow of the Hong Kong Institute of Certified Public Accountants (Practising). He had served on the Professional Risk Management Committee of the Institute and had been a member of the Institute's Liability Reform Task Force for a number of years. He is also a member of the Financial Reporting Review Panel of the Financial Reporting Council.

LILIAN HO
Chief Financial Officer

Lilian Ho has been appointed as the Chief Financial Officer with effect from 30 October 2017.

After successfully developed her career in professional practice within one of the International accounting firms and BDO, with her last position as Senior Manager serving in two of our Assurance Groups, Lilian joined a telecommunication multi-national listed group with headquarter in Shenzhen. Lilian worked as Financial Controller in this listed group.

Lilian is a Hong Kong Certified Public Accountant (Practising) and a fellow member of the Association of Chartered Certified Accountants.

Welcome on board!

CANDY HO
Principal
Assurance Services

Candy Ho has been appointed as Principal of Assurance with effect from 1 October 2017.

Candy has extensive experience in handling assignments of listed and private companies operating mainly in Hong Kong and Mainland China over a wide variety of industries including property investment, management and development, financial services, nuclear energy, catering, hotel operation, trading, manufacturing and construction. Candy is also involved in various transaction service assignments.

Candy is a Hong Kong Certified Public Accountant.

EDDIE SZE
Principal
Assurance Services

Eddie Sze has been appointed as Principal of Assurance with effect from 1 October 2017.

Eddie has extensive experiences in serving Hong Kong and Singapore listed company audit assignments over a variety of industries, including manufacturing, media and advertising, printing, mining and tissue engineering. He is also involved in various transaction support assignments, such as initial public offerings and financial due diligence in acquisitions of companies.

Eddie is a Hong Kong Certified Public Accountant, a Fellow Member of the Association of Chartered Certified Accountants and Chartered Financial Analyst.

GORDON LEE
Principal
Assurance Services

Gordon Lee has been appointed as Principal of Assurance with effect from 1 October 2017.

Gordon has extensive experience in handling assignments of listed companies and private companies operating mainly in Hong Kong and Mainland China over a wide variety of industries including trading, manufacturing, money lending and financial services. Gordon is also involved in transaction service assignments including initial public offerings in Hong Kong.

Gordon is a member of CPA Australia.

IVY LEUNG
Principal
Assurance Services

Ivy Leung has been appointed as Principal of Assurance with effect from 1 October 2017.

Ivy has extensive experiences in serving Hong Kong listed company audit assignments over a variety of industries, including casino, hotel and entertainment, manufacturing, commodity trading, property construction and investment. She is also involved in various transaction support assignments, such as initial public offerings.

Ivy is a Fellow Member of the Association of Chartered Certified Accountants.

KEVIN CHAU
Principal
Assurance Services

Kevin Chau has been appointed as Principal of Assurance with effect from 1 October 2017.

Kevin has extensive experience in handling assignments of listed companies and private companies operating mainly in Hong Kong and Mainland China over a wide variety of industries including IT company, manufacturing and trading, natural resources, ship-management and chartering, and financial and investment advisory services.

Kevin is a Hong Kong Certified Public Accountant and an associate member of the CPA Australia. He is also a CFA charter holder.

TERRY LAU
Principal
Assurance Services

Terry Lau has been appointed as Principal of Assurance with effect from 1 October 2017.

Terry has extensive experience in handling audit assignments of listed companies operating mainly in Hong Kong and Mainland China. Terry has served clients in industries of manufacturing and trading, retail, financial services, media, exhibition-related business and property development.

Terry is also involved in corporate finance projects including initial public offerings, mergers and acquisitions and other capital market transactions.

Terry is a Fellow of the Hong Kong Institute of Certified Public Accountants and an associate of the Institute of Chartered Accountants in England and Wales. He is also a Certified Fraud Examiner, an associate of the Hong Kong Institute of Chartered Secretaries, an associate of the Institute of Chartered Secretaries and Administrators and an ordinary member of the Hong Kong Securities and Investment Institute.

WING LEUNG
Principal
Assurance Services

Wing Leung has been appointed as Principal of Assurance with effect from 1 October 2017.

Wing has extensive experience in handling audit assignments of listed companies operating mainly in Hong Kong and Mainland China over a wide variety of industries, including real estate development, construction, trading and manufacturing.

Wing was also involved in various transaction support assignments including initial public offerings and acquisition of companies.

Wing is a Hong Kong Certified Public Accountant.

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IFRS Interpretations Committee - Agenda Decisions (June 2017)


HKFRS / IFRS
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HKFRS/IFRS Update 2017/09
IFRS Interpretations Committee - Agenda Decisions (September 2017)


HKFRS / IFRS
UPDATE 2017/10

HKFRS/IFRS Update 2017/10
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