

# APERCU



## BDO GLOBAL ANNUAL RESULTS 2014

Strategic merger activity & organic growth see BDO surpass US\$7bn revenues

- Revenues up 8.81%
- 28 mergers completed in the past 12 months
- **BDO China revenues up 16%, ranked fourth in the CICPA league table of accounting firms in China – ahead of EY & KPMG**
- **BDO ranked as the 5<sup>th</sup> largest accounting firm globally in annual revenue**

BDO announced a total combined fee income for the year ended 30 September 2014 of US\$ 7.02bn / €5.17bn – an 8.81% increase year on year in US dollars. BDO is now represented in 151 territories.

BDO's growth can largely be attributed to three factors:

- The scale and breadth of BDO's ongoing merger programme, designed to ensure the network leads the consolidation of the mid-tier
- Organic growth across the board - best exemplified in the US and China
- New firms joined BDO in Fiji, Réunion Island, Bangladesh, Papua New Guinea and Sierra Leone, and a number of firms enlarged their territories, adding Laos (Malaysia),
- Afghanistan (Pakistan) and the Maldives (Sri Lanka)

These newly merged and acquired firms bring new people, talent and expertise to the BDO network which now includes 110 member firms. Including its exclusive alliances, BDO has 1,328 offices and just under 60,000 partners and staff worldwide. Our people numbers represent an increase of 5.4% compared to 2013.

### BDO Global performance

Year to 30 September	2014	2013	2012	2011
Combined fee income	€5.17 billion (US\$7.02 billion)	€4.92 billion (US\$6.45 billion)	€4.63 billion (US\$6.02 billion)	€4.07 billion (US\$5.68 billion)
Number of countries	151	144	138	135
Number of offices	1,328	1,264	1,204	1,118
Total staff	almost 60,000	56,389	54,933	48,890

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# CAN THE PROPOSED UNIVERSAL RETIREMENT PROTECTION SCHEME WORK?

In our previous Apercu articles, we have dealt with the short term and long term Mandatory Provident Fund (MPF) changes put forward by the MPF Schemes Authority (MPFA) in reply to the 2.6 million employees' call for immediate and major change of the whole MPF system. Apart from the employees, various interest groups have raised concerns to the government urging the increase in the retirement protection system for the elderly, in particular, those who are not covered by MPF savings and living below the poverty line. The Chief Executive, Mr CY Leung said in his Policy Address 2013 that the Hong Kong Government is looking into the possibility of bringing in a

universal retirement protection system for all the eligible elderly of Hong Kong.

As we all know, the MPF system has been criticised by Hong Kong employees since it was launched in December 2000 as "high fees and low returns" and savings on MPF would unlikely be enough to protect the lifestyles of retired employees. Faced with the challenges of the peak retirement period in the coming ten years, there have been concerns that this group of elderly, housewives and low-income earners were not protected under the MPF/ORSO (Occupational Retirement Schemes Ordinance) schemes. Given that such elderly groups would

hardly have personal savings to meet their daily living expenses, there could be a large number of elderly people living in poverty in the near future. So, the carrying out of a whole retirement protection system for the elderly is getting near.

In view of the above needs, the government has put in place a research team led by Professor Nelson Chow of the University of Hong Kong, to take on research for future growth of retirement protection in Hong Kong. A research report was put out in August 2014 listing the studies of retirement protection systems in other countries and giving opinions collected from various political parties, affected bodies, interest groups

Table 1

World Bank five-pillar retirement protection model					
	0	1	2	3	4
Existing retirement protection measures in Hong Kong	Old Age Allowance (OAA)	Lacked of "pillar one" retirement living protection in Hong Kong as in the World Bank five-pillar model	MPF	Voluntary MPF contribution	Elderly Health Care voucher (EHCV)
	Old Age Living Allowance (OALA)		ORSO	Personal Savings	Special public transport rates for the elderly
	Disability Allowance		Civil Service pension (old system)		Support by children
	Comprehensive Social Security Assistance (CSSA)				

Table 2

Parties to fund the monthly demo-grant	Proposals	Comments
The government	Half of the anticipated annual spending on demo-grant	A one-off fund of HK\$50 billion to be put in at the beginning of the scheme
Employers and employees	A payroll old age tax to be implemented	Employers and employees would pay the payroll old age tax according to the employee's level of monthly income (further details as shown in Table 3)

Table 3

Payroll old age tax		
Employee's level of monthly income (in HK\$)	% of employer's contribution**	% of employee's contribution**
Below \$6,500	1%	N/A
Below \$10,000	1%	1%
Between \$10,000 to \$19,999	1.5%	1.5%
Between \$20,000 to \$120,000*	2.5%	2.5%

\* Maximum limit

\*\* Maximum contribution is HK\$3,000

Table 4

Pillar	1	2	3	4
Type of social safety	Central Provident Fund (CPF)	Home Ownership	Healthcare grants	Workforce income top-up
Functions	Enables citizens to save up funds for retirement	Helps citizens purchase own home	Provides a sustainable healthcare system for all citizens	The scheme encourages older, low-wage workers to continue working to help finance their retirement and medical needs

and referring to the public and forecasting choices and results, with findings and proposals of the research team.

According to the findings of the research team, Hong Kong lacked retirement living protection open to all Hong Kong citizens, that is "pillar one" as given by the World Bank five-pillar retirement protection model (details as shown in Table 1).

The research team suggested that setting up a kind of whole demo-grant should be the best way of considering the future development of Hong Kong retirement protection and an amount for the rate of demo-grant may be set at HK\$3,000 per month. To pay for the monthly demo-grant to the elderly, the team said that the capital would be funded by the methods as shown in Table 2.

The suggested demo-grant is a non-means tested whole retirement scheme which is open to all Hong Kong permanent residents aged 65 or above. The payment of the monthly demo-grant of HK\$3,000 is aimed at providing basic living protection for all senior citizens in the coming peak ageing period to ease old-age poverty by the contributions of employers, employees and the government.

Whilst the elderly welcome the suggested scheme, on the other hand there are certain parties against the proposal as they doubt how it would be financially possible in the long run. In particular, the research report gave a forecasted final cash balance of HK\$13.5 billion in 2041 (the cash projection is prepared based on the price index of 2013) which would be unable to meet the total cost of demo-grant and its administration costs from 2042 onward, unless the government puts extra funds into the scheme or employers and employees made additional contributions by raising the rate of the old age payroll tax.

Apart from the above concerns, the suggestion would undoubtedly receive much opposition from both employers and employees as they have to make monthly payroll old-age tax ranging from 1% to 2.5% at salary level of an employee (with a cap at HK\$3,000 per month each) on top of the MPF contribution (at present capped for MPF contribution

HK\$1,500 each per month). This will definitely reduce the employee's take-home pay further, and employers will inevitably increase their running costs. The suggested payroll tax would have a negative effect on the profitability of businesses, in particular small and medium businesses, as rents and wages would have eaten up a large part of their profits. On that basis, the commercial success of Hong Kong in attracting foreign investors would be weakened as compared to other Asian countries. In addition, the suggested payroll tax rate would be reviewed from time to time due to inflation and other factors and any change in the payroll tax is bound to be open to question.

If the above suggestion is not workable for us, what alternative is there for the government to protect the senior citizens in their retirement years? Maybe the government can refer to the social security systems of other APAC countries, such as Singapore, Australia, Malaysia, and so on, to help the future development of universal retirement protection in Hong Kong.

Take Singapore as an example, with its social safety net consisting of four pillars as per Table 4.

The four pillars of the social safety net take care of the most important needs of the elderly in Singapore, ie housing, retirement, and medical. As compared to the social safety net of Singapore, the Hong Kong Government is also providing social housing, medical benefits, allowances and help for the elderly and the poor (eg OAA, OALA, EHC, CSSA, and so on) citizens and has also used the MPF system for retirement protection of the 2.6 million Hong Kong employees. Unfortunately, there are people who are not covered by the above benefits. In addition, there are certain failings in the MPF savings system which would not be able to protect the retirement period of its members.

Perhaps, some may argue that the amount of the Central Provident Fund (CPF) contributions by employers and employees are much higher than MPF, so it would have enough funds to share out the contributions to provide full cover of the retirement needs of the Singaporeans. Indeed, the amount of contributions does matter; but it is the method of the two systems that makes the difference.

The CPF contributions are centrally managed by the Central Provident Fund Board, one of the legal boards of the Singapore government. The CPF board is the manager for the CPF savings of members, which invests and manages CPF savings for different retirement protections, such as ordinary account (OA) for housing, insurance, investment and education; special account (SA) for old age and investment in retirement-related financial products and the medisave account for hospital expenses and approved medical insurance. Only funds in excess of S\$20,000 in OA and S\$40,000 in SA are to be invested in limited deposits and financial accounts and the combined fund in OA and SA for S\$60,000 will be frozen for retirement purposes. CPF savings earn standard interest set by the government and the first joint funds from OA and SA for S\$60,000, earn extra interest to top up CPF savings. CPF savings on OA can be used for full or partial payment to purchase residential property.

Whilst MPF savings are managed by the MPF trustees, appointed by MPF service providers and approved by the MPFA, which are mainly banks and insurance companies. The MPFA is a quasi-governmental organisation responsible only for regulating the operations of MPF and ORSO schemes. The day-to-day operations of the MPF funds rest under the control of the MPF service providers.

The MPF system has been harshly criticised due to the following shortcomings:

1. The choice of the MPF service provider is in the hands of employers instead of employees. The investments of employer's MPF funds go into payment funds managed by the MPF service providers who charge high management fees but their performance is not justifiable.
2. The employees are only allowed to manage their own share of MPF savings to their preferred MPF service provider but the employer's share of MPF savings is not transferrable at their wishes.
3. The employees would suffer loss of MPF savings due to the uncertainty of the financial market and global economic situations. There is no guarantee of return on MPF savings for employees to have peace of mind in their retirement years.

4. The Employment Rule allows the employers to balance the severance payment (SP)/long service payment (LSP) against the employers' benefits made up in the MPF/ORSO schemes for employees. The MPF/ORSO savings of the employee concerned will therefore be reduced.
5. Employees are unable to use MPF savings for other purposes before reaching their retirement age of 65 (early withdrawal of MPF savings can only be made under particular circumstances).

It is time for the government to consider taking immediate action to change the MPF system to ensure the retirement savings of employees. The MPF reform proposals may include:

- To make up full transferability of MPF;
- To remove rules that allow employers to offset SP/LSP against MPF/ORSO accrued benefits for employees;
- To introduce a "core fund" run by the government with low management fees and a reasonable return;
- To launch an electronic method for quick

processing of MPF payments and clearance between trustees;

- To allow employees to use part of the MPF savings for other uses (like purchase of own residential property, tuition fees for further studies, etc) before 65.

Other alternatives to provide greater protection of the poor/elderly may include:

- To put a one-off fund into the existing governmental charitable fund such as Community Care Fund to draw up new help programmes for retirement protection for the poor elders;
- To do a means test on applications of help programmes for the elderly to avoid wasting the use of resources;
- To review any possibility of finding extra revenue to finance the ever-increasing spending on social security and retirement protection.

In view of the difficult nature of the proposal and the dispute surrounding it, as well as its long-term financial issues for Hong Kong, the

government and various interest groups will need to have in-depth studies and discussion before the government can progress further. We believe that the government could come up with a better suggestion than the proposed old age payroll tax.

*Source: Research Report on Future Development of Retirement Protection in Hong Kong - Executive Summary*

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## SETTING UP A ROBUST ESG MECHANISM

In recent years, to meet stakeholders' needs, stock exchanges of many countries have been putting effort into setting up the disclosure requirements in relation to environmental, social and governance (ESG). These countries include Singapore, the United States, Australia, China and so on. The Hong Kong Stock Exchange (HKEx) also issued the "Environmental, Social and Governance Report Guidelines" (known as ESG guidelines) consultation paper in

December 2011. Its consultation conclusion (the Conclusion) was released in August 2012. At the moment, the ESG guidelines are still the recommended best practices where a listed company has the choice of following the disclosure requirements or not. However, HKEx also suggested in the Conclusion that the ESG guidelines may go into the rules for "Comply or Explain" someday.

### Not just a reporting exercise

At the moment, many of the listed companies in Hong Kong have put into effect at an early stage the disclosure requirements under the ESG guidelines. Some companies even benchmark their disclosures with international standards such as Global Reporting Initiatives (GRI), United National Global Compact (UNGC), The International Integrated Reporting Council (IIRC), and so on. Among the reports, these companies have demonstrated their practices and achievements in major aspects including workplace practices, environmental protection, operating practices and community involvement. According to the ESG guidelines, listed companies will, as a minimum, report on the aspects illustrated in **Figure 1**.

Sustainability is the final goal. However, it is more important to understand the management philosophy behind these ESG practices. Coming from the idea of corporate social responsibility (CSR), companies' activities are expected to go beyond the legal requirements and take on the features of ethics and integrity into their businesses. Some successful companies can see the ESG opportunities and even improve their sustainability competitive advantage by building ESG ideas into their business plans, products and even their organisation's ideas and purpose.

As businesses develop their plans for sustainability, in many cases this means taking more from their supply chains by demanding more sustainable services/products, commitments to lowering emissions and showing better data/KPI commitment.

Figure 1



Figure 2



<b>ESG governance and assessment</b>	To set up an authority structure and system which cover the team of key staff, their roles and duties, ways of reporting, vital policies and procedures, etc; to assess and check on stakeholders.
<b>Formulate ESG strategy</b>	To understand the needs and concerns of different stakeholder groups and set out the aims and objectives which ESG practices would like to achieve. To carry out ESG plans aimed at areas that will affect the organisation most.
<b>Develop and implement ESG commitments</b>	To develop various ideas and action plans covering the main areas mentioned above; to decide on the important stages and hold key staff to account for results; to set up ways to make sure that information related to ESG is found in an accurate, complete and timely manner.
<b>Communicate and report on ESG performance</b>	To decide on the type of message to be sent through ESG reporting; to make sure that the reporting content and ESG performance are in line with the ESG aims and objectives.
<b>Evaluate and improve on ESG practices</b>	To constantly review the ESG practices and pick out ways for continual improvements and taking on higher reporting standards.

**Establish the ESG mechanism**

No matter what story you would like to tell in the ESG report, that story must be backed up by actions. Like any other actions in a company, once it has decided to invest in ESG practices which has its own important goals, that company must start to think about what needs to happen to manage ESG practices. Getting satisfactory and suitable working figures for the use of resources, or understanding how to change energy used into CO<sub>2</sub> emissions to be declared is just a small part of the game.

The risks to businesses from not managing sustainability matters well are high, such as:

- Fines and warnings for non-following
- Loss of retail and business customers and contracts
- Higher than necessary operating costs leading to lower business success
- Higher costs of recruiting staff
- Greater media examination

More importantly, management will develop the ESG mechanism as in the ESG pattern, shown in Figure 2.

**Points to be considered during the start-up stage**

Apart from the paths to be made up as mentioned above, ESG responsible staff will also consider the following when setting up the ESG methods.

**Awareness and interest**

Though some people may have heard of the idea of ESG, they may have different understandings and explanations. The company will carry out an awareness analysis among the management level staff to find out their overall understanding about the idea, their knowledge about different ESG standards available, areas that they are most interested in and, more importantly, their problems faced with ESG during daily workings.

**Connection with ESG**

To get the real benefits from ESG methods, management will identify what and to what extent do the company's main business have direct or indirect connection with ESG. As far as the ESG guidelines are concerned, it will not be difficult to identify such connection. For example, every organisation must have staff and then improving the workplace can be one of the areas that the company will focus on. The following are some common methods that can be considered:

- Recycling waste & conservation
- Using energy-efficient office equipment
- Supporting volunteering with local community projects
- Using trusted local suppliers
- Providing a safe working environment
- Educational skills training for staff
- Improving equal employment practices in the workplace

**Picking out obstacles**

There might be rules and policies, or sometimes small groups of staff within your company, that prevent you from successfully carrying out the ESG. They might even prevent your company from laying out your priorities or taking the first step towards seeing this through.

Consider whether your company has any of these attitudes and practices that discourage openness, or human resources policies that are unequal and ignoring safety regulations. Sometimes, staff behaviour may be affected by local community attitude or behaviour, especially when such behaviour may lead to illegal activities such as making bribes to clinch business contracts.

It is important to pick out such obstacles to successfully carry through responsible business methods and make good risk assessments on the causes and effects of identified obstacles.

**Speed of ESG practice improvement**

Sustainability is a long-term project and the business will, from the start, come up with an overall plan, budgets and achievement markers for measuring performance. Setting up the budget has always been difficult for ESG methods, as management may carry out cost and benefits analyses and management will tend to be cautious and careful on passing the budget as the outcome is usually unknown. Thus, ESG projects of some companies may be withdrawn in its early stage or the pace of development has been very slow.

To ensure the ESG project can continue and win approval from stakeholders, the company will start off with some small orders that can provide specific benefits, eg energy saving equipment improvement and then move on to another area based on the first success.

For further enquiries about ESG practice or reporting, please contact Ricky Cheng, Director of Risk Advisory Services, at (852) 2218 8266.

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# BDO GLOBAL NETWORK DEVELOPMENT AT A GLANCE

## BDO appoints new member firm in Papua New Guinea

**B**DO is pleased to announce the appointment of a new member firm in Papua New Guinea, effective 1 October 2014.

Formerly part of the PKF network, the new BDO Papua New Guinea was founded in 1983 by David Guinn, the current managing partner, with the opening of an office in Mount Hagen. The firm has earned an excellent reputation in the local market, growing to a total staff of 25 and is now based in the capital, Port Moresby. BDO Papua New Guinea's core services are audit & assurance, accounting, tax, insolvency and business advisory: the firm's insolvency practice is significant, compared to its nearest competitors. The new BDO firm has significant industry expertise in agriculture (especially coffee), retail, medical services, engineering, aid donor and government services.

## BDO among Norway's 10 best employers

**B**DO Norway achieved a 10th place in the Great Place to Work (GPTW) survey 2014. This makes BDO Norway the only firm in its industry that was ranked top 10 in the category "large businesses". The survey is based on employee surveys covering more than 50 questions.

## BDO appoints new member firm in Sierra Leone

**B**DO is pleased to announce the appointment of a member firm in Sierra Leone, effective 1 November 2014. The new BDO Sierra Leone was previously part of the PKF network.

The firm was established in 1963 and is today based in the capital, Freetown. Led by the Managing Partner, Samuel Noldred, and Brinsley Kwame Johnson, the firm counts a total staff of 40+. The core services provided by BDO Sierra Leone are audit and assurance, tax, payroll, corporate services and consulting. They have significant industry expertise and major clients in the financial services, manufacturing and non-profit sectors.

## BDO USA announces major midwest expansion through addition of SS and G, Inc.

**B**DO USA, LLP, one of the nation's leading professional service organisations, announced a major expansion of its midwest presence through the addition of more than 370 staff, including 36 partners, from SS&G, Inc and its SS&G Parkland subsidiary (SS&G). A top 40 accounting firm nationally, SS&G partners and employees are based in multiple offices in the Cleveland, Akron, Columbus, Cincinnati and Chicago markets. SS&G provides a full range of accounting and consulting services to a diversified client base with significant strength in the manufacturing, distribution, restaurant, healthcare, nonprofit, real estate and technology industries. The combination of BDO and SS&G is subject to customary closing conditions and is expected to be completed on 1 January 2015. SS&G Wealth Management, SS&G Healthcare and Paytime Integrated Payroll Services are not part of this transaction and will continue to serve their clients as independent entities.

# JOHNSON KONG ELECTED AS THE COUNCIL MEMBER OF HKICPA



**B**DO Hong Kong Managing Director Johnson Kong elected as the council member for the Hong Kong Institute of Certified Public Accountants (HKICPA) for a new term of two years.

Johnson has a history of over 20 years of dedicated services to the Institute, its members and the accounting profession through this active participation in different boards, committees, interest groups, task forces and events with proven track records.

Apart from his in depth understanding of the operating environment of practising accountants, his professional focus on non-assurance services can bring a different perspective to the Council.

# BDO NEW APPOINTMENTS



**ERIK TANG**  
Director  
Assurance Services

Erik Tang was appointed as Director of Assurance with effect from 1 October 2014.

Erik has extensive experience in serving listed clients in both Hong Kong and the US. Prior to joining the Firm, Erik has worked in both the assurance and professional practice departments of an international professional firm for many years. His expertise covers audit, financial due diligence, and other assurance services related to Initial Public Offerings and other public filings. He is also experienced in providing technical consultation on financial reporting and assurance issues.

Erik has led the financial statements and SOX audits of various listed issuers of both the New York Stock Exchange and NASDAQ, and has in-depth knowledge and experience in SEC financial reporting requirements.

Erik is a Certified Public Accountant in Hong Kong and a fellow of the Association of Chartered Certified Accountants.



**JOANNE HO**  
Principal  
Assurance Services

Joanne Ho was appointed as Principal of Assurance with effect from 1 October 2014.

Joanne has extensive experience in handling audit assignments of Hong Kong listed companies over a wide variety of industries, including manufacturing, property development and investment, forestry operations, toll road construction and operations. Other than Hong Kong listed entities, Joanne has substantial experience in "B" share audit of Chinese companies listed on the stock exchanges in Mainland China. She also specialises in transaction support assignments, such as Initial Public Offerings and financial due diligence in acquisitions of companies.

Joanne is a Certified Public Accountant in Hong Kong.



**PETER NG**  
Principal  
Assurance Services

Peter Ng was appointed as Principal of Assurance with effect from 1 October 2014.

Peter has extensive experiences in serving Hong Kong listed company audit assignments over a variety of industries, including trading, property investment and development, resources mining and manufacturing. He was also involved in various transaction support assignments and financial due diligence in acquisitions of companies.

Peter is a member of the Association of Chartered Certified Accountants.



**WINNIE CHEUNG**  
Principal  
Assurance Services

Winnie Cheung was appointed as Principal of Assurance with effect from 1 October 2014.

Winnie has extensive experience in handling Hong Kong and Singapore listed company audit assignments over a wide variety of industries, including manufacturing, electronics, consumer products and medical clinics. She also specialises in transaction support assignments, such as Initial Public Offerings and financial due diligence in acquisitions of companies.

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

# HOW TO CLASSIFY A JOINT OPERATION AND A JOINT VENTURE UNDER HKFRS11 JOINT ARRANGEMENTS

**A** joint arrangement is one where two or more parties have joint control.

The parties involved in a joint arrangement are usually bound by a contractual arrangement, which gives two or more of those parties joint control of the arrangement. Joint control exists when the contract arrangement gives all the parties, or a group of the parties, control of the arrangement together and when the full agreement of all the parties or a group of the parties is required for making decisions about particular activities to do with the joint arrangement.

Joint arrangements have grown in popularity in recent years. International joint arrangements in particular are becoming more popular, especially in capital-demanding industries such as oil and gas exploration, mineral extraction, and motor

manufacturing. Generally speaking, parties in joint arrangements will share risks and costs and create economies of scale, also called synergy effect.

Under HKFRS 11 Joint Arrangements, a joint arrangement is classified as either a joint operation or a joint venture. This classification is very important as it leads to two different accounting treatments.

The classification of a joint arrangement depends upon the rights and obligations of the parties to the arrangement.

The rule set out in HKFRS 11 is that where those in agreement with a joint arrangement have rights to the assets and obligations for the liabilities relating to the arrangement, this joint arrangement is classified as a joint

operation. Investors in this type of arrangements must account for their share of assets, liabilities, income and expenses (ie line-by-line accounting). Where the parties to the arrangement have rights to the net assets of the arrangement, then the arrangement will be considered as a joint venture and equity method accounting under HKAS 28 (2011) would be applied.

The classification assessment of a joint arrangement is therefore an important consideration for applying the appropriate accounting treatment and it is dealt with in further detail below.

The following four questions are helpful when deciding the classification of a joint arrangement:

## (i) Is the joint arrangement formed through a separate vehicle?

**If yes:** go to question (ii)

**If no:** the joint arrangement is a joint operation

A separate vehicle is a separately identifiable financial structure, including separate legal entities or entities recognised by law, regardless of whether those entities have a legal personality.

This standard sets out a clear definition that a joint arrangement not made through a separate vehicle is a joint operation. Although it is possible that a contractual term for this type of joint arrangement might be one under which the parties have rights only to the net assets of the arrangement, International Accounting Standards Board (IASB) considers that this is rare. So, no extra assessment for this type of joint arrangement that is not made through a separate vehicle is brought in.

## (ii) Does the legal form of the separate vehicle give those involved rights to assets and obligations for liabilities relating to the arrangement?

**If yes:** the joint arrangement is a joint operation

**If no:** go to question (iii)

Separate vehicles could be incorporated through many different legal forms, for example, limited liability companies, unlimited liability companies, partnerships and limited partnerships. Each of these legal forms brings different rights and obligations to those concerned. Careful consideration of the relevant laws and regulations is necessary for each type of the legal forms when deciding the correct classification of a joint arrangement.

A legal form which does not give separation between the parties and the separate vehicle is considered a joint operation. For instance, partnerships are usually established to give the parties rights to assets and place unlimited obligations for liabilities to the parties. This type of legal form is seen as no separation between the parties and the arrangement. It would therefore be classified a joint operation.

On the other hand, in some jurisdictions, a limited liability company usually confers to be separate between the parties of joint arrangements and the vehicle itself (ie the joint arrangement itself, rather than the parties of joint arrangements, is responsible for the debts and obligations of the arrangement). The parties of joint arrangements are only liable to the extent of their investments in the vehicle, or sometimes their obligations to contribute any unpaid/extra capital. In such case, the assessment of the rights and obligations conferred upon the parties by the legal form indicates that the arrangement is a joint venture. However, it is reminded that the terms agreed by the parties in the arrangements and other related facts and circumstances can override the legal form used.

**(iii) Do the contractual terms of the joint arrangement state that the parties have rights to assets and obligations for liabilities relating to the arrangement?****If yes:** the joint arrangement is a joint operation**If no:** go to question (iv)

Normally, the rights and obligations agreed by the parties in their legal arrangements match, or do not conflict, the rights and obligations placed on the parties by the legal form of the separate vehicle in which the arrangement has been structured.

However, those concerned may use the contractual arrangement to alter or modify the rights and obligations conferred by the legal form of the separate vehicle used for the agreement. HKFRS 11 gives comparisons of common terms in contractual arrangements for a joint operation and joint venture. Some key points were laid out in the following table:

	Joint operation	Joint venture
<b>Rights to assets</b>	The parties share all interests in the assets relating to the arrangement in a specified proportion.	The assets brought into the arrangement or subsequently acquired by the joint arrangement are the arrangement's assets. The parties have no interests (ie no rights, title or ownership) in the assets of the arrangement.
<b>Obligations for liabilities</b>	The parties share all liabilities, obligations in a specified proportion.	The joint arrangement is liable for the debts and obligations of the arrangement.
	The parties are liable for the obligations of the arrangement in a specified proportion.	The parties are liable to the arrangement only to the extent of their respective investments in the arrangement or to their respective obligations to contribute any unpaid or additional capital to the arrangement, or both.
	The parties are liable for claims raised by third parties.	Creditors of the joint arrangement do not have rights of recourse against any party with respect to debts or obligations of the arrangement.
<b>Revenues and expenses</b>	The allocation of revenues and expenses on the basis of the relative performance of each party to the joint arrangement. Such as, they might be allocated on the basis of the capacity that each party uses in a plant operated jointly or on the basis of a specified proportion such as the parties' ownership interest in the arrangement.	Each party's share in the profit or loss relating to the activities of the arrangement.

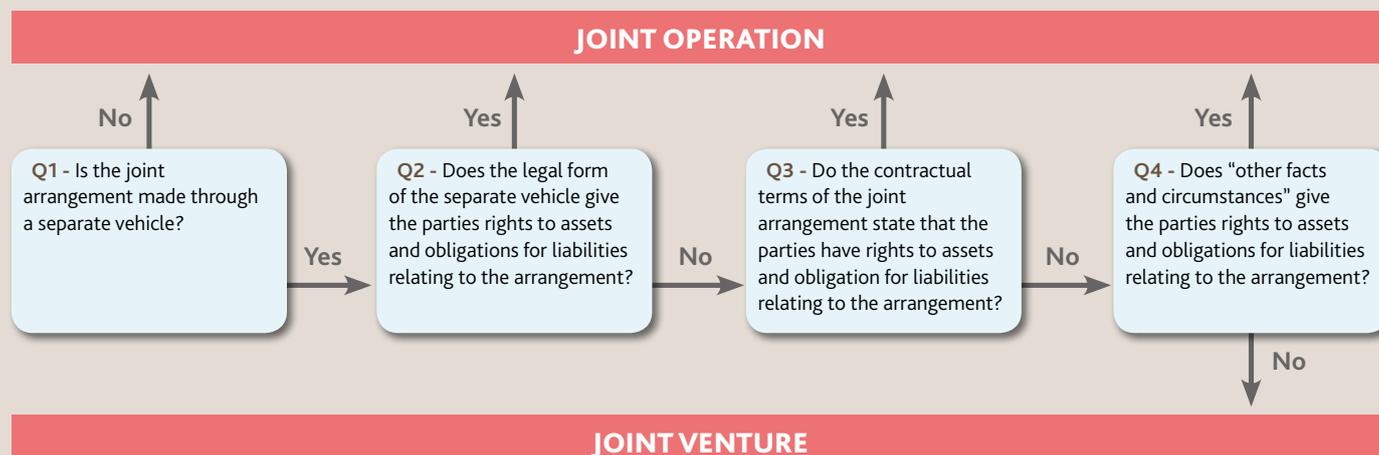
**(iv) Does "other facts and circumstances" give the parties rights to assets and obligations for liabilities relating to the arrangement?****If yes:** the joint arrangement is a joint operation**If no:** the joint arrangement is a joint venture

If we have answer "no" to question (ii) and (iii), looking at other facts and circumstances could lead to such arrangement being classified as a joint operation when other facts and circumstances give the parties rights to the assets, and obligations for the liabilities, to do with the arrangement. There is no explicit definition of "other facts and circumstances" under HKFRS 11. When judging "other facts and circumstances", we have to look at the purpose and design of the arrangement and where the cash flows funding of the arrangement comes from.

For example, an arrangement designed to sell all output to the parties of the joint arrangement indicates that the purpose of the arrangement is to give direct rights to all the economic benefit of the assets of the arrangement to the parties. It also implies that the parties are obligated to finance substantially the operations (ie to operate at a break-even level) because the parties are the only source of funding. The form of this arrangement placing all liabilities from the arrangement on the parties is likely to be a joint operation.

For other examples, if the parties changed the terms of the arrangement with options to buy output so that the arrangement is able to sell the output to the market, the position has changed as the arrangement is now intended to make profit and also use the cash flows from its customers to finance its operation and pay liabilities. This means the parties do not have contractual obligations to fund the liabilities of the arrangement. In this case, the arrangement is considered probably to be a joint venture.

## Joint arrangement classification assessment

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## CORPORATE GOVERNANCE REVIEW 2014

**B**DO's Corporate Governance Review 2014 (The Review) has been released. This is the ninth year the firm has presented this extensive analysis of the corporate governance practices of Hong Kong's major listed companies.

The Review found that among the 238 major Hong Kong listed companies surveyed, the rate of full compliance with the Corporate Governance Code (the Code) remained relatively unchanged. There are still less than half of both Hang Seng Index (HSI) and Hang Seng Composite Index (HSCI) companies achieving full compliance, whereas Hang Seng China Enterprises Index (HSCEI) companies reported a decline from 67% to 58% in their compliance level (Table 1).

The further dip in the full compliance level with the Code was mainly due to the introduction of new provisions. Companies should avoid complacency and take initiative to improve the compliance level. The newly proposed changes related to internal control and risk management to be effective in 2016 by the Hong Kong Exchanges and Clearing Limited (HKEx) hopefully will prompt companies to enhance their governance to better manage their risks and challenges.

The BDO study also reveals an increase in non-compliance in the area of internal control review, and deterioration in its quality of disclosure. The majority of companies undertook the annual review of the effectiveness of their internal control systems, but there is a decline from 96% to 94% and 92% to 88% for HSCI and HSCEI companies respectively (Table 2). As fewer companies assessed the effectiveness of their internal controls, they offered less insight

about the subject in their report. Compare to the figures of 2013, there is a decline in all three indices companies in disclosing how the board and committees review the effectiveness of their internal control systems (Table 3).

If you would like to obtain a copy of the full report, please visit "Resources > Research > Corporate Governance Review" at [www.bdo.com.hk](http://www.bdo.com.hk) or contact us at [info@bdo.com.hk](mailto:info@bdo.com.hk)

**Table 1 Percentage of companies claiming to have full compliance with the Corporate Governance Code**

	2012	2013	2014
HSI	53%	42%	42%
HSCI	54%	37%	38%
HSCEI	80%	67%	58%

Source: BDO Corporate Governance Review

**Table 2 Percentage of companies claiming to have reviewed the effectiveness of the group's internal control at least annually**

	2012	2013	2014
HSI	92%	100%	100%
HSCI	87%	96%	94%
HSCEI	80%	92%	88%

Source: BDO Corporate Governance Review

**Table 3 Percentage of companies claiming to have disclosed the process the board and committees applied when they reviewed the effectiveness of the internal control system**

	2012	2013	2014
HSI	67%	84%	81%
HSCI	52%	67%	58%
HSCEI	50%	62%	60%

Source: BDO Corporate Governance Review

# YOU NEED STRONGER RISK MANAGEMENT AND INTERNAL CONTROL

Changes to Corporate Governance Code and Corporate Governance Report will be effective from 1 January 2016

The Hong Kong Stock Exchange (HKEx) issued the Consultation Paper on risk management and internal control - Review of The Corporate Governance Code and Corporate Governance Report (Consultation Paper) - in June 2014 and responses to this Consultation Paper were completed in October. Consultation Paper Conclusion has just been made in December. HKEx announced on 19 December 2014 that the amendments to the Corporate Governance Code and Corporate Governance Report (the Code) will apply to accounting periods beginning on or after 1 January 2016, which gives the issuers one year period for compliance preparation.

The key changes to the Code would mainly affect three areas, including C.2 Internal Control, C.3 Audit Committee and Disclosure Requirements.

## C.2 Risk management and internal controls

- The revised code has highlighted the concept of risk management. By definition, risk management is a process of identifying, evaluating, prioritising, managing and monitoring risks. It is meant to manage and control business risks to an acceptable level, but not to remove them absolutely. Nevertheless, a structured risk assessment is the first step to effective risk management.
- The revised code C.2 would require the board to oversee the risk management and internal control systems on an ongoing basis, rather than a quick review at year end.
- The management (eg CFO, COO) is required to provide a confirmation to the board on the effectiveness of these systems. It is expected that such confirmations should be declared based on sufficient due diligence.
- All listed companies are required to establish an internal audit function which must be independent, competent and sufficiently empowered. It can be established internally, shared with the group's existing resources or outsourced to a competent professional party.
- It becomes a code provision that the board should consider specific issues in the annual review of the risk management and internal control systems. Particularly, issuers must also disclose their procedures of handling and disseminating inside information.

## C.3 Audit committee

Minimum requirements to review the committee's terms of reference would include changes to the Code Provision in the Audit Committee section. It is the responsibility of the audit committee to watch over the issuer's financial reporting system, risk management and internal control systems, to discuss the



risk management and internal control systems with management and to ensure that it has carried out its duty to run effective systems. The responsibility of the audit committee also includes consulting with management over the risk management and internal control systems. This should make sure that resources are sufficient and staff qualifications and experience are up to standard. It will also consider training programmes, budget of the issuer's accounting and its financial reporting duty.

## Disclosure requirement

The Recommended Disclosure in S. Internal Control section would be changed to Mandatory Disclosure Requirement. This means that the issuer must include a directors' statement that it has carried out a review of its risk management and internal control systems in the annual report under Code Provision C.2.1. The following would also be required to be stated by the issuer in its Corporate Governance Report:

- Whether the issuer has an internal audit function;
- How often the risk management and internal control systems are reviewed, the period covered, and where an issuer has not carried out a review during the year, an explanation as to why not; and
- A statement that a review of the effectiveness of the risk management and internal control systems has been carried out and whether the issuer considers them effective and sufficient.

It is a common practice that the issuers would have a period of one year after the changed Code comes into use, to make preparations for following the new changes. Listed companies in Hong Kong are advised to consider developing better risk management and internal control systems from now on to make sure that they are

kept in the near future when the new Corporate Governance Code and Corporate Governance Report (the Code) comes into force on 1 January 2016.

At present, listed companies are strongly advised to consider reviewing and deciding whether they have risk management and internal control duties in place and/or whether systems can properly assist new needs. It has been noted that risk management and internal control duties have been absent or weak in small or medium sized listed companies. The changes to the current Code would affect such companies the most. Therefore, small or medium sized issuers should consider from now on developing a complete risk management and internal audit system that should also fit their size. As it is, many small or medium size issuers have already set up an internal audit system. However, staff qualifications could be questioned as well. It is also a useful solution to outsource these roles in the first couple of years to provide time for the company to set up in-house.

For further enquiries about corporate governance over Corporate Governance Code and Corporate Governance Report, please contact **Patrick Rozario**, Director and Head of Risk Advisory, at (852) 2218 3118 or [patrickrozario@bdo.com.hk](mailto:patrickrozario@bdo.com.hk)

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HKFRS/IFRS 9 Financial instruments (2014)



**HKFRS/IFRS UPDATE 2014/14**  
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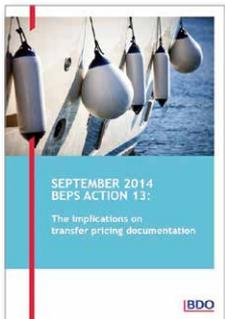
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