



30 June is the fiscal year end in Australia, but is mid-year closing for many businesses in the other side of the hemisphere. It is also the eve of Canada Day, and eve of Hong Kong SAR Establishment Day. If you are counting, it's exactly 2 days away from the mid-point (182nd day) of a common year – perfect time for a mid-year review.

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30 June: Mid-year review

We begin this edition with two articles from our Australian member firms – one concerning economic outlook and another on probity audit – a service that are expected to grow in demand.

On the other side of the Pacific Rim is Vancouver, which has an article on new financial reporting frameworks in Canada.

China continues with new circulars clarifying tax measures; while the quality of some local audits is questioned by the PCAOB.

Hong Kong takes a look at

the progress of the super stamp duty legislation proposed some 7 months ago as well as a bill allowing deduction on purchase of IPR.

To establish legal certainty on deduction against taxable income, Indonesia has a new guideline on donations and social infrastructure construction expenses

Malaysia reports on the growing trend and statistics of tax audit and the approach by the tax authority in this matter.

Working towards closer

economic ties with Singapore, Mauritius recently received a Singapore State visit.

South Korea updates us on tax changes as well as a tax ruling exempting VAT on non-residents making sales through domestic cybermall.

There's a surge of accounting irregularities detected on Chinese companies listed in Singapore in 1H of 2011. We have a timely article from Singapore on fraud deterrence and detection.

News of our regional firms

Australia - Saward Dawson, our member firm in Melbourne, has recently admitted Joshua Morse as partner of their Business

Advisory division. Joshua joined the firm as a young graduate some twelve years ago and is

amongst the many young Gen Y professionals at Saward Dawson. The firm is widely recognised as a pace-setter in

Highlights:

- *Expansion of Melbourne member firm*

recruiting and training young Chartered Accountants.

The firm has also just completed a major

expansion and redevelopment of their office buildings. With doubling office space and state of the art facilities for staff, the firm is

committed to serving their clients to the highest standards.



Australian Economy – Road blocks Ahead!

Australia came out of the Global financial Crisis reasonably unscathed compared to many other countries. A strong economic foundation and banking sector together with timely fiscal and monetary policy played key roles in minimising downside.

Australia is well placed to continue to leverage off Chinese and regional growth with huge demand for our natural resources and exports.

Our economy has also been impacted recently by significant flood disasters which will make the Government's job harder to bring the budget back to surplus within their targeted timeframe.

Australian residential

housing prices have continued to increase due to demand and undersupply. The Reserve Bank is keeping an eye on inflation and we can expect interest rates to rise in the short to medium term.

Although the high Australian dollar has benefited some sectors of our economy, we are seeing industries such as manufacturing, exports, retail and tourism starting to contract and be adversely affected. This sector by sector story is leading to a multi-speed economy however our economic growth is still heavily reliant on our resources boom.

The big debate for Australia is the commitment by our Federal Labor

Government to introduce a Carbon Tax. This controversial policy is causing much debate and has the potential to divide. Although most see the need to respond in some way to climate change issues, the debate revolves around questions such as – should Australia lead the way in such policy initiatives, what cost to our economy and living standards and will it make a difference anyway?

- *"...big debate...to introduce a Carbon Tax..."*

Probity Audit and Advice



Stantons International

To many people in the accountancy profession, the concept of probity audit or probity advice is at worst an unknown concept or at best a gray area that is not really understood. For this article, we will refer to it as probity advice, or probity advisory services, as this is what our Perth-based practice of Stantons International, provides to the public sectors in Western Australia, elsewhere throughout Australia and to overseas aid agencies such as AusAID and the World Bank.

Probity advisory work has been an important part of the structure for over fifteen years, almost since the concept started to be employed in mainly public sector procurement and contracting processes.

In summary, the concept involves participating in tendering and contracting processes as an independent advisor, or auditor, to provide advice to the buying agency and ultimately to the government, that the procurement processes have been conducted according to the relevant government policies and guidelines and that the

process has been fair to all concerned, has been free from bias or inequity and is unlikely to be challenged by unsuccessful proponents on the basis of the procurement process being a flawed process.

The concept arose from the widespread adoption of competitive tendering and contracting philosophies in the early 1990s, where governments started to realise that with this new emphasis on outsourcing and contracting for services, that the public sector was vulnerable to accusations of bias or unfair treatment of tenderers if those tendering processes were not carefully monitored by independent, external parties.

The legal and accounting professions have tended to monopolise the provision of the services, with each claiming their legitimate right to carry out the work. However, we would say that with an audit element to the role, accounting has the greater claim for legitimacy! Other groups who are starting to take an interest in the concept include project managers and independent

arbitrators.

While not yet widely embraced by the private sector, we see that as the concepts become more widely understood and the benefits that can arise through this external review process are appreciated by the private sector, the more likely this will become a fundamental part of the governance processes of private sector companies when conducting their contracting processes.

Typically, the probity assignment can range from a short-term, relatively simple procurement activity, say four to six weeks, through to major, complex projects of four to five years, such as the current five year contract for the support of the AU\$2.00bn Fiona Stanley Hospital Project.

Under the leadership of Kevin Donnelly, CPA, Principal Probity and Procurement, we are developing our team as a centre of excellence in this relatively new specialisation, including the provision of training in the concepts.

"...arose from the widespread adoption of competitive tendering..."



New Financial Reporting Frameworks in Canada

There have been many recent changes to accounting standards in Canada which are now impacting financial reporting. Depending on an entity's nature, entirely different accounting frameworks will be applied when preparing either interim or annual financial statements.

The accounting frameworks and their effective dates are as follows:

Publicly accountable enterprises

Publicly accountable enterprises are required to apply International Financial Reporting Standards (IFRS) for fiscal periods beginning on or after 1 January 2011. There are some exceptions to this timeframe related to rate regulated entities which have the option to defer adoption by one year to 1 January 2012, and investment companies and segregated accounts of life insurance enterprises which are not required to apply IFRS until 1 January 2013.

Private enterprises

Private enterprises are required to apply either Accounting Standards for Private Enterprises

(ASPE) or IFRS, if determined to be more appropriate, for fiscal periods beginning on or after 1 January 2011. ASPE was specifically developed for private enterprises in Canada and is tailored to meet their needs and therefore would be expected to be adopted by most private entities.

Not-for-profit organizations

Not-for-profit organizations are required to apply either Accounting Standards for Not-for-Profit Organizations (ASNPO) or IFRS, if determined more appropriate, for fiscal years beginning on or after 1 January 2012. ASNPO has been adapted from the current not-for-profit standards and therefore significant changes are not expected from current financial reporting and it is expected that most not-for-profit organizations would adopt ASNPO.

Pension plans

Pension plans will also have new accounting standards called Accounting Standards for Pension Plans (ASPP). Although these standards are a continuation of the current accounting standards for pension

plans. Pension plans must apply ASPP to their investment portfolio and pension obligations but can apply either IFRS or ASPE to other balances because this new standard only addresses these specific balances.

First time adoption

For all of the above accounting frameworks, there are requirements and considerations on transition including accounting policy changes and changes to the recorded financial statement balances and disclosures. First time adoption rules are applied at the date of transition which is the beginning of the comparative figures. Application of these new accounting standards is retroactive although there is some relief for specific account types that can be prospectively applied and therefore easier to implement.

Adoption of new accounting standards can, in some cases be more complex than expected with new information and disclosure requirements therefore it is best to understand the implications early on to make the transition easier.

"Application of these accounting standards is retroactive..."

Preferential tax policies for hi-tech companies on overseas income

The Ministry of Finance and the State Administration of Taxation (SAT) have jointly issued the "Circular on Applicable Tax Rate and Tax Credit on Overseas Income for High Technology Companies".

According to the Circular, hi-tech companies, which have their hi-tech qualifications recognized by measuring R&D expenses, total revenues, sales revenues and sales of hi-tech products/ services associated with domestic and overseas operations, are able to enjoy preferential enterprise income tax policies for high technology companies on their overseas income. Essentially, applicable enterprise income tax rate on these hi-tech companies' overseas income is 15%, and they can apply the 15% tax rate when calculating their total taxable income.

Calculation formula for individual income tax over year-end bonus issued.

The SAT issued a document clarifying that should an employer bear the individual income tax which should be paid by employees themselves

over the year-end bonus, the amount of individual income tax is classified as employees' addition income and to be converted to taxable individual income. Should an employer bear employees' individual income tax over year-end bonus and recognize these amounts in overheads, the overheads are not deductible in the calculation of enterprise income tax. The new rule has been effective from 1 May 2011.

PCAOB Concerned about Audits of Chinese Reverse Merger Companies

On 14 March 2011, the Public Company Accounting Oversight Board (PCAOB) issued a Research Note titled "Activity Summary and Audit Implications for Reverse Mergers Involving Companies from the China Region: 1 January 2007 through 31 March 2010".

This is a follow-up on its July 2010 Staff Audit Practice Alert No. 6 which raised concerns about compliance with standards for audits of companies with substantially all their operations outside the U.S. These two pronouncements show that the PCAOB is highly concerned about practices in this area and may investigate and impose

sanctions against accounting firms to raise awareness of these issues.

According to the Research Note, 159 companies from the China region accessed the U.S. capital markets by means of a reverse merger transaction (Chinese Reverse Merger or CRM) during the period from January 2007 to March 2010, more frequently than by IPOs. CRMs tend to have relatively lower levels of revenue, assets, and market capitalization; and the auditors of many CRMs are "triennial firms". These firms are inspected by the PCAOB once every three years, as opposed to annually.

In both the Research Note and Practice Alert No. 6, the PCAOB identified factors that may have a negative effect on the audits of CRMs: language differences; use of third parties to perform audit work; additional travel time and expense; and understanding of local business environment. The second factor, the use of third parties, appears to be of greatest concern to the PCAOB. In Practice Alert No. 6, the PCAOB cited examples of improper reliance on or coordination with third parties, including one case where a U.S. firm engaged a local Chinese consulting firm whose personnel could speak and read Chinese to perform audit work.



"...Chinese Reverse Merger...tend to have relatively lower levels of revenue, assets and market capitalization..."



Serving Hong Kong Since 1994

“...trader in Hong Kong ...provides them without charge to processor/ sub-contractors across the boarder... No deduction is allowed...”

Super Stamp Duty and deduction of IPR cost

While Hong Kong has always been admired for the speed of commercial transactions, two tax proposals in 2009 and 2010 have progressed slowly when seeking approval by the Legislation Council (LegCo).

Super Stamp Duty

In our December 2010 Newsletter we reported the Government’s proposal to introduce Super Stamp Duty (SSD) to curb speculative investments in residential properties. SSD was supposed to kick in on all sales where the properties concerned were acquired on or after 19 November 2010.

Due to different views on definition of acquisition and relaxation provisions in forced disposals, the SSD legislation only received its approval on 22 June 2011.

Meanwhile, property prices continue to rise as the SSD discourages disposal and has reduced the supply of housing in the secondary market. With demand for housing remaining strong, the SSD has merely reduced the number of property transactions but has not achieved the objective of curbing prices.

IPR cost

Separately, LegCo is studying the bill for allowing deduction of acquisition cost of specified intellectual property rights (IPR), initially promised to be introduced in 2009. The stumbling block is the vexed effort to include anti-avoidance provisions in the bill, which include:

- (a) disallow deduction for purchase from associated party;
- (b) empower the Authority to allocate consideration or determine the true market price for purchase of IPR;
- (c) disallow deduction where the IPR are used overseas by a person other than the taxpayer.

Point (a) is a common feature in our anti-tax avoidance legislation. In light that capital gain is not taxable in Hong Kong, in the absence of (a), a transfer between associated parties can create non-taxable gain to the transferor while resulting in deductible cost to the transferee.

Point (b) may occur in a business acquisition where the taxpayer arbitrarily allocates a lump sum consideration into cost for tangible assets, goodwill and IPR

to maximize its deduction claim. The use of fair market price will ensure proper and non-excessive deduction for IPR.

Point (c) refers to the situation where a trader in Hong Kong acquires IPR and provides them without charge to processors /sub-contractors across the border (e.g. China, Vietnam) to manufacture goods that the trader will purchase for resale. No deduction is allowed to the trader.

The industries are of course disappointed with (c) given that manufacturing is nowadays rarely carried out in Hong Kong and it is common to “license” IPR without charge to manufacturers across the border to produce the goods. To disallow the deduction means disincentives to traders who are prepared to invest in IPR.

The Administration has suggested that traders can receive a license fee from the manufacturers to establish a direct connectivity between the IPR acquisition cost and license fee income. However, this suggestion is seen as an unpopular move because (i) it would inflate the tax cost arising from withholding tax on license fee payment from

aboard to Hong Kong; and (ii) it would add complexity to the possessing arrangement as having to manage streams of income in opposing directions - license fee from IPR and purchase costs for finished goods.

A good thing arising from the LegCo discussions is the confirmation by the

Administration that license fee income on acquired IPR (as opposed to self-developed IPR) used outside of Hong Kong can be regarded as offshore and non-taxable.

If the bill is approved, it will become effective from tax year 2011/12 and will apply to IPR defined as comprising copyrights, trademarks and registered designs.

Cost deduction will be over the shorter of (a) 5 tax years, or (b) the remaining tax year if the IPR lifespan is less than 5 years.

Patent and knowhow, which fall outside the definition of specified IPR, is currently and will continue to be allowed 100% deduction in the acquisition year.

HONG KONG

(Continued)

Guideline on deduction of donations and social infrastructure construction expenses

The Indonesian Government through the Minister of Finance Regulation (PMK) Number: 76/PMK.03/2011 year 2011 has issued a Guideline for Recording and Reporting the National Disaster Management Donation, Research and Development Donation, Education Facility Donation, Sports Development Donation, and Social Infrastructure Construction Expense which can be deducted from the Gross Income.

By the existence of PMK, hopefully there will be legal certainty about particular donations and expenses which can be deducted from gross income so that it can decrease the tax expense of the donors or payers.

Pursuant to the PMK, donations and/or expenses as described

below can be deducted from the gross income for the purpose of calculating taxable income:

- a. Donation for the national disaster management which constitutes donation for the national disaster victims delivered directly through the disaster management organizations or delivered indirectly through the institutions or any parties possessing permit from the authorized agencies/institutions to collect disaster management fund;
- b. Donation for research and development which constitutes donation in the interest of research and development performed throughout the
- c. Education facility donation which constitutes donation in the form of education facilities delivered through educational institutions;
- d. Donation for sports development which constitutes donation to develop, improve, and coordinate one or joint organization of the Olympic sports kind/branch and is delivered through sports development institutions; and
- e. Social infrastructure construction expense which constitutes expenses paid to build the facilities

Republic of Indonesia area and delivered through the research and development institutions;

INDONESIA



Russell Bedford Indomitra
Management & Legal Consulting

"...legal certainty about particular donations and expenses which can be deducted from gross income..."

INDONESIA

(Continued)

and infrastructures for public interest that is not-for-profit in nature.

Donation and/or expenses aforementioned can be deducted from gross income on condition that:

1. Taxpayer possesses the fiscal net income based on the Annual Income Tax Return of the previous Tax Year;
2. The delivery of donations and/or expenses do not cause a loss in the Tax Year when the donation is delivered;
3. Being supported by the valid evidences; and
4. The institutions receiving donations and/or expenses possess the Tax Payer Identity Number except for the organizations treated specially as the tax subject as regulated in the Laws on Income Tax.

Concerning the value of donation and/or social infrastructure construction expense which can be deducted from gross income aforementioned, for one year it is limited to not

more than 5% of fiscal net income of the previous Tax Year.

Donations and/or expenses aforementioned cannot be deducted from gross income of the givers in case donations and/or expenses are given to the related parties.

Donations aforementioned are deducted from the gross income of the tax year when the donations are delivered, while social infrastructure construction expense aforementioned can be deducted from the gross income of the tax year when the social infrastructure is made used of.

In case the social infrastructure construction is implemented in more than one Tax Year, the social infrastructure construction expense is charged all at once as the deducting agent of gross income of the tax year when the social infrastructure is made used of.

Receipt of donations and/or expenses shall be attached by the donor Taxpayer to the Annual Income Tax Return of the Tax Year.

Besides regulating the

procedure for bookkeeping and documentation from the side of donors or payers, the PMK also regulates the reporting from beneficiaries.

In this respect, the disaster management organization and/or institution or the beneficiaries in the context of national disaster management shall submit the report on donation reception and distribution to the Director General of Taxes every three months.

For institutions receiving donations and/or other expenses, besides receiving donations in the context of national disaster management, they shall also be obliged to submit the report on donation reception to the Director General of Taxes no later than the end of Tax Year when the donations and/or expenses are received.

"...social infrastructure construction expense is charged all at once...when the social infrastructure is made use of"

Tax audit and investigation – A growing trend

MALAYSIA



RUSSELL BEDFORD MALAYSIA

The self assessment system (SAS) was introduced in Malaysia in 2001 and 2004 for companies and individuals respectively. Under this SAS, taxpayers have the onus of estimating and computing their own taxes.

In order to ensure that there is no loss of tax revenue, tax audits and investigations are carried out under the self assessment regime to encourage and ensure voluntary compliance with the tax laws and regulations.

In the 2011 Budget our Honorable Prime Minister and Minister of Finance further stressed that the Government is committed to strengthening the nation's financial position by increasing revenue collection through an increase in enforcement and audits.

According to published statistics, the number of audit cases settled increased fourfold to 1,052,939 cases in 2008 compared to 2007 and further increased to 1,399,660 cases in 2009, whilst the number of tax investigation cases settled in 2009 increased by 30% to 834. The additional taxes and penalties collected from these enforcement activities increased to RM3.9bil in

2009 compared to RM2.4bil in 2008.

In ensuring that enforcements are carried out in a fair and transparent manner, the Tax Audit Framework and Tax Investigation Framework were rolled out by the tax authority to outline the rights and responsibilities of audit officers, tax payers and tax agents during an audit.

The tax authorities may carry out an external tax audit at the taxpayer's offices at regular intervals. Any omission of income discovered during a tax audit will result in additional assessment and penalties being imposed. In this regard, it has become pertinent for taxpayers to adopt a proactive approach by ensuring that there is proper record keeping of primary evidence (receipts, vouchers, invoices, credit notes etc) and there must be full disclosure of income.

Tax audit is one avenue for the tax authorities to detect tax evasion. Tax evasion is a deliberate act of a taxpayer understating his income or overstating his expenses by unlawful means with the intention of deceiving the tax authority. If, based on precise and definite evidence, it is suspected

that the taxpayer is deliberately trying to avoid paying tax or has committed an act of willful evasion, tax investigation may be carried out. There are two categories of tax investigation i.e. civil tax investigation and criminal tax investigation.

The common methods employed by the tax authority in selecting cases for tax audit and investigation are:

- a. Through risk analysis;
- b. Information from informers and/or public;
- c. Review of income tax return;
- d. Based on specific industries; and
- e. Based on specific issues for a certain group of taxpayers.

The tax audit framework also sets out the penalty for offences /errors identified during or before an audit which may be up to 100% of tax undercharged. However, a concessionary rate of 45% may be imposed for the first offence. As for tax investigation cases, the penalties imposed may be equal to treble the amount of tax undercharged (300%) and upon prosecution, the person may face an imprisonment term of not less than 3 years.

"...proactive approach by ensuring ...proper record keeping of primary evidence..."

MALAYSIA

(Continued)

The key challenge for all taxpayers is to ensure compliance with the tax laws and regulations and continuously ensure there are sufficient and appropriate documentations of their

business affairs. Failure to do so can be a costly affair in terms of financial and reputational risks.

MAURITIUS



"...offer Singapore investors a solid base of operation for ventures into Africa"

Singapore State Visit to Mauritius

President S.R. Nathan of Singapore was on a State Visit to the Republic of Mauritius in early June 2011. He was accompanied by a business delegation comprising members of the Singapore Business Federation (SBF).

The SBF signed two memoranda of agreement in Mauritius with the Board of Investment (BOI) and with the Mauritius Chamber of Commerce and Industry (MCCI). Present at the

signing, the Singapore President expressed his support for closer economic ties between the two nations.

BOI Chairman Maurice Lam, who is a Singapore permanent resident, said, "it's the right time for Singapore companies to look at Africa and to be there in the beginning of the transformation - that's going to happen to the African economies."

Mauritius is looking for growth beyond its

traditional European markets and into emerging markets on the African continent and can offer Singapore investors a solid base of operation for ventures into Africa. Mauritius' membership of regional trade bodies such as SADC and COMESA grants preferential access into African markets. Furthermore, Mauritius has signed double taxation avoidance treaties with 14 African states and with Singapore.



2011 Tax Law Changes, Transfer Pricing and Tax Ruling Cases

SOUTH KOREA

CJAC 천지회계법인
CHEON JI ACCOUNTING CORPORATION

Tax law changes

We summarized below some of the major changes to keep you up-to-date on tax law changes in Korea.

1. *Income classification of signing bonus with condition of return (Individual Income Tax Law Basic Rule)*

The new Basic Rule of the Individual Income Tax Law which was enacted on 31 March 2011 makes clear income classification and taxation of signing bonus received from a company by an employee who has special ability or skill.

Signing bonus received by an employee pursuant to an employment contract will be classified as earned income (salary income).

If the employment contract has the condition that the employee must return the signing bonus to the company when he resigns within certain period ("contract period"), the signing bonus received when he makes the employment contract with the company will be divided in proportion to the contract period and the income tax for the current year will be levied on the portion of signing bonus corresponding to the

current year.

2. *Report of "offshore financial account" (effective from 27 December 2010)*

If a Korean resident (including a foreigner who has address or abode in Korea for more than 5 years in aggregate during the past 10 years) or a Korean company owns the "offshore financial account" opened in foreign countries, it is obligated to report the detailed information on the account to the Korean tax authority. The offshore financial account which is subject to reporting is an account having more than Won 1 billion for at least one day of the fiscal year.

The detailed information of offshore financial account includes (1) information on the owner of the account such as name, address, etc, (2) account information such as the account number, name of the financial institution and the highest amount of the daily ending balance during a fiscal year, (3) information on the beneficial owner in case the account is held by a nominal owner, and (4) information on the joint owner in case the account is jointly held by two persons or more.

The owner of the offshore financial account is required to report detailed information on the account to the Korean tax authority in June of the following year (i.e. in June 2011 for FY 2010). A fine would be imposed if the report is not submitted by the due date.

Transfer pricing

1. *Result of tax audit on 'offshore tax evasion' 1Q 2011.*

The Nation Tax Service announced the tax assessment of Won 474 billion as a result of tax audit on 'offshore tax evasion' cases for the first quarter of 2011.

The types of the 'offshore tax evasion' cases are:

- a. disguising tax status to foreign company or non-resident and concealing income in the tax haven jurisdictions (total tax assessment, Won 410 billion);
- b. tax evasion through international transaction including creating counterfeit purchase (total tax assessment, Won 37 billion);
- c. omitting profit on share transfer and interest income (total tax assessment, Won

"Signing bonus...classified as earned income..."

"...offshore financial accountsubject to reporting is an account having more than Won 1 billion for at least one day..."

SOUTH KOREA

(Continued)

“...non-resident registers with a domestic open market...not within the scope of “business place” ...under the Value Added Tax Law...”

- d. 14 billion); tax evasion through forged transfer of foreign situated immovable property and through foreign currency trades (total tax assessment, Won 13 billion); and
 - e. other various types.
2. *OECD meeting with private sector*

On 29 March 2011, Working Party No. 6’s Special Session on the Transfer Pricing Aspects of intangible (WP6 TPI) met with private sector representatives to discuss the valuation of intangible for transfer pricing purposes. As part of the OECD’s robust framework to minimize controversies and

maximize tax certainty in relation to the transfer pricing aspects of intangibles, it is expected that the WP6 will continue to develop the Transfer Pricing Guidelines on intangibles.

VAT ruling cases

Tax ruling case regarding VAT on open market (cybermall)

A tax ruling (jaebuga-167, 2011.3.18) was issued for the case where a non-resident registers with a domestic open market (e.g., a cybermall) as a seller, and he/she sells the products via the open market and delivers them directly to the domestic customers from overseas. The recent ruling on this

case provides that the open market is not within the scope of “business place” of the non-resident under the Value Added Tax Law, and thus the non-resident shall not be subject to VAT on selling products through the domestic open market under Article 2 of the Value Added Tax Law.

SINGAPORE

STEVEN TAN RUSSELL BEDFORD PAC
Public Accounting Corporation

FRAUD DETERRENCE AND DETECTION

Since the start of the 2011 financial reporting season, several Singapore-listed companies based in China have faced alleged accounting irregularities. An analysis of their risk profile using Donald R. Cressey’s fraud triangle revealed several startling similarities

Motive / pressure	<ul style="list-style-type: none"> Shrinking market share. Increased competition. Rising costs.
Rationalisation / attitude	<ul style="list-style-type: none"> Senior management are also major shareholders of the company ie you cannot steal from yourself; you are just “borrowing”.
Opportunity	<ul style="list-style-type: none"> The companies are flushed with cash from recent IPOs or private placement. The chairman and chief executive is the same person or they are immediate family members.

Fraudulent financial statements undermine the sanctity of capital markets and increase the cost of capital for legitimate companies seeking capital for economic expansion. The recipe for fraud management revolves around deterrence, detection and a healthy dose of professional skepticism.

Deterrence

The key to fraud deterrence is the removal of one or more elements in the Fraud Triangle from the company. The removal of ‘Opportunity’, through the implementation of a system of internal control, is traditionally viewed as the most efficient and effective way to deter fraud.

Unfortunately, the integrity of a company’s internal control is very much dependent on the control environment. The control environment sets the tone of the company and is the foundation for all other elements of internal control in the COSO framework. When fraud is perpetuated by senior management who are also the major shareholders, it is often difficult to prevent it without a board of directors who are sufficiently independent.

In June 2011, the Corporate Governance Council of Singapore proposed a

comprehensive list of revisions to the existing Code of Corporate Governance (the Code). The Code applies to listed companies and provides principles and guidelines on how a company is directed and controlled, covering aspects such as remuneration, board composition, risk management and shareholder rights.

The proposed changes aim at strengthening the independence of the board by:

- ***Increasing the number of independent directors*** - If the roles of the chairman and chief executive are filled by the same person, or if they are immediate family members or if the chairman and chief executive are both part of the management team, then at least half of the directors should be independent.
- ***Re-defining an independent director*** - A director who is a substantial shareholder, partner or executive officer in the company for the past three financial years, or is an immediate family member of the substantial shareholder will be deemed non-independent. Directors who have

served on the board for more than nine years will also be considered non-independent.

A board with a critical mass of independent directors will act as a very strong deterrent to errant senior management and ensure that the interests of other stakeholders are taken care of.

Detection

The performance of trend analysis and cross-sectional analysis on ratios and other financial information are usually prescribed by auditing textbooks to detect fraud or misstatements.

- ***Trend analysis*** - Comparing current ratio indicators to previous months’ or years’ ratio indicators in order to identify abnormal trends. For instance, trade receivables turnover (days) usually stay in a very predictable band. A sudden increase in trade receivables turnover over prior years should prompt the auditors to pay particular attention to the collectability of trade receivables and the authenticity of sales recognised during the year. Another situation that should raise a few eyebrows is when a company

“...the control environment sets the tone of the company and ... foundation for all other elements of internal control in the COSO framework...”

(Continued)

“...data mining techniques...to search for underlying patterns or relationship among data...”

keeps showing good income numbers year on year when it does not generate any positive operating cashflows.

- **Cross sectional analysis** - Many companies use financial ratios as benchmarks to measure their performance against their industry peers. Auditors can review the industry standard against the company to identify inconsistent trends with the industry as a whole. A company with growing sales numbers when the industry is undergoing a cyclical downturn should raise some alarm bells.

In addition to these traditional methods, data mining techniques can be used to extract information from different database system in order to search for underlying patterns or relationship among data. For example, reviewing data from the general ledger and sorting them by posting date / time and users may reveal interesting information

on when top-line adjustments are made and by whom. Other simple data analytics include searching for invoices with round numbers ie \$1,000, \$50,000, \$800,000 etc and identifying customers with the same mailing address.

Professional skepticism

While the primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the company and management, auditors do still get some heat when things go wrong. It is important that we maintain professional skepticism throughout the audit and be cognizant of the fact that our traditional audit procedures that are effective for detecting error may not be effective in detecting fraud, especially when the risk of management override is high. We will also need to be more open to new technologies and methodologies and how they can help mitigate our audit risks and improve the effectiveness and efficiency of our audits.

Disclaimer

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Business consultants with a
global perspective

Russell Bedford Asia Pacific Offices Contacts



Australia - Melbourne

Bruce Saward
bruce@sawarddawson.com.au
www.youraccountant.com.au

Australia - Perth

John Van Dieren
jvdieren@stantons.com.au
www.stantons.com.au

Australia - Sydney

Greg Ralph
gralph@gouldralph.com.au
www.gouldralph.com.au

Canada - Vancouver

Patrick Mangan
pmangan@berrismangan.com
www.berrismangan.com

China - Beijing / Shanghai

Guoqi Wang
guoqi_wang@huaander.com
www.huaander.com

China - Hong Kong / Guangzhou / Shanghai

Jimmy Chung
jimmychung@russellbedford.com.hk
www.russellbedford.com.hk

India

Shreedhar T. Kunte
sharp@bom3.vsnl.net.in
www.sharp-tannan.com

Indonesia

Syarief Basir
sbasir@russellbedford.co.id
www.russellbedford.co.id

Korea (South)

Brian Shim
yss@cjac.net
www.cjac.net

Malaysia

Loh Kok Leong
lohkl@russellbedford.com.my
www.russellbedford.com.my

Mauritius

Jaye C. Jingree
jjingree@krossborder.intnet.mu
www.krossborder.com

Pakistan

Rashid Rahman Mir
rsrirlhr@brain.net.pk

Philippines

Marcelino Mercado
info@mcjcpas.ph
www.mcjcpas.ph

Singapore

Douglas Tan
douglas@stcsamasmgt.com.sg

Taiwan

Arthur Lin
jsgcpa@russellbedford.com.tw
www.russellbedford.com.tw

Vietnam - Hanoi

Hung Duy Pham
hung.duy.pham@kctvietnam.com
www.kctvietnam.com

Vietnam - Ho Chi Minh City

Van Anh Thai
van.anh.thai@kctvietnam.com
www.kctvietnam.com



Russell Bedford International

Russell Bedford House
250 City Road
London EC1V 2QQ
United Kingdom

marketing@russellbedford.com

www.russellbedford.com

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