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# Morison KSi Asia Pacific Newsletter

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Morison KSi

# Editorial

**Sachin Vasudeva,**
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The 2018 Morison KSi Asia Pacific conference was held in the beautiful city of Da Nang in Vietnam. Vietnam is one of the fastest-growing economies of the world, with growth rates in excess of 6.5% as forecast by the Asian Development Bank.

Vietnam's robust economic growth has been driven by vigorous manufacturing and export expansion, rising domestic consumption, and strong investment fuelled by foreign direct investment (FDI) and domestic enterprises. The agriculture sector has also shown tremendous improvements. A detailed article on the economic outlook of Vietnam is included in this newsletter to understand how Vietnam has progressed over the years.

As I write this Editorial, I am reminded of the very first Morison conference that I attended; it happened to be in Vietnam, in Ho Chi Minh, in the year 2001. Vietnam will therefore always be special for me.

A special thanks to Dr Barry Jay Epstein, Chun Wee Chiew and Roshini Ganesan for contributing to this newsletter, besides all other member firms.

Enjoy your reading!

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# **Vietnam:** Investment opportunities

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## Macro outlook: stability to support growth

### ECONOMIC INDICATORS

Vietnam closed 2017 with many positive signs. The country has shown the world its stable growth and attractiveness to investors, both local and global.

**Gross domestic product**

GDP growth reached 6% in 2014, and since then it has been above 6%. Forecasts show that this trend will continue.

**Purchasing Managers' Index**

PMI came in at 52.5 in December, the highest monthly level in the last quarter of 2017. The reading shows solid expansion of the sector for 25 consecutive months and all but 2 months since August 2013. Vietnam PMI outperformed almost all other ASEAN countries.

**Foreign direct investment**

FDI remains the engine that drives Vietnam's growth. Disbursed FDI rose 11% to US$17 billion, while registered FDI rose an impressive 44% to US$36 billion.

**Consumption**

With the consumer confidence index at a record high of 117, real retail sales grew 9.5% in 2017. Low inflation and a 6.5% increase in minimum wages should support similar gains in 2018.

**Credit**

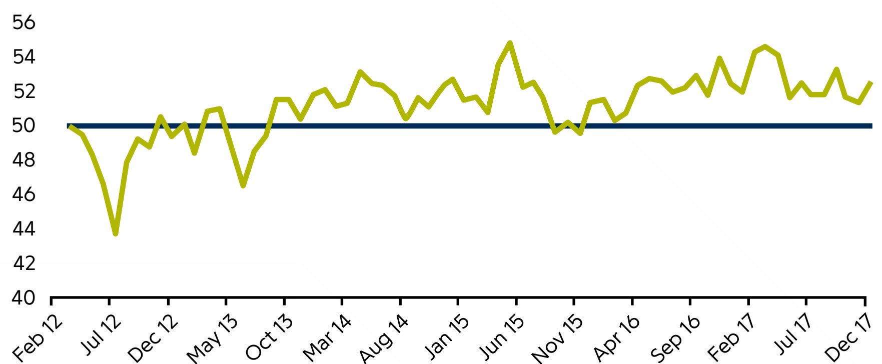
Credit growth of 19% in 2017 was high enough to support

ASEAN countries GDP growth

| | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|---|
| Vietnam | 5.2 | 5.4 | 6.0 | 6.7 | 6.2 | 6.8 |
| Indonesia | 6.0 | 5.6 | 5.0 | 4.9 | 5.0 | 5.1 |
| Philippines | 6.7 | 7.1 | 6.1 | 6.1 | 6.9 | 6.7 |
| Malaysia | 5.5 | 4.7 | 6.0 | 5.0 | 4.2 | 5.9 |
| Thailand | 7.2 | 2.7 | 1.0 | 3.0 | 3.3 | 3.9 |

Source: World Bank

Vietnam Purchasing Managers' Index




Source: Nikkei, Markit, Vietcap

ASEAN countries' PMI

| | Jan 2017 | Feb 2017 | Mar 2017 | Apr 2017 | May 2017 | Jun 2017 | Jul 2017 | Aug 2017 | Sep 2017 | Oct 2017 | Nov 2017 | Dec 2017 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Vietnam | 51.9 | 54.2 | 54.6 | 54.1 | 51.6 | 52.5 | 51.7 | 51.8 | 53.3 | 51.6 | 51.4 | 52.5 |
| Philippines | 52.7 | 53.6 | 53.8 | 53.3 | 54.3 | 53.9 | 52.8 | 50.6 | 50.8 | 53.7 | 54.8 | 54.2 |
| Myanmar | 51.7 | 51.9 | 53.1 | 52.9 | 52 | 49.4 | 49.1 | 49.3 | 49.4 | 51.1 | 51.6 | 51.1 |
| Singapore | 51.6 | 48.6 | 50.4 | 50.1 | 48.7 | 50.3 | 47.9 | 51.0 | 48.6 | 51.3 | 47.4 | 44.7 |
| Thailand | 50.6 | 50.6 | 50.2 | 49.8 | 49.7 | 50.4 | 49.6 | 49.5 | 50.3 | 49.8 | 50.0 | 50.4 |
| Indonesia | 50.4 | 49.3 | 50.5 | 51.2 | 50.6 | 49.5 | 48.6 | 50.7 | 50.4 | 50.1 | 50.4 | 49.3 |
| Malaysia | 48.6 | 49.4 | 49.5 | 50.7 | 48.7 | 46.9 | 48.3 | 50.4 | 49.9 | 48.6 | 52.0 | 49.9 |
| ASEAN | | | | | | 50.0 | 49.3 | 50.4 | 50.3 | 50.4 | 50.8 | 49.9 |

Source: Nikkei, Markit, Vietcap

Summary of Vietnam macro forecast

| | 2014 | 2015 | 2016 | 2017 | 2018F | 2019F |
|---|---|---|---|---|---|---|
| GDP growth (%- 2010p) | 5.98 | 6.68 | 6.21 | 6.81 | 6.70 | 6.80 |
| Agriculture (%) | 3.49 | 2.41 | 1.36 | 2.90 | 3.00 | 3.70 |
| Industry & Construction (%) | 7.14 | 9.64 | 7.57 | 8.00 | 7.90 | 8.50 |
| Construction (%) | 7.07 | 10.82 | 10.00 | 8.70 | 8.90 | 9.50 |
| Manufacturing (%) | 8.45 | 10.60 | 11.90 | 14.40 | 12.10 | 14.10 |
| Service (%) | 5.96 | 6.33 | 6.98 | 7.44 | 7.50 | 8.05 |
| Retail Sale (% | 10.60 | 9.50 | 10.20 | 10.86 | 11.70 | 12.60 |
| Industrial Production Index (%) | 7.60 | 9.80 | 7.50 | 9.40 | 9.10 | 9.70 |
| CPI (average, % YoY) | 4.09 | 0.72 | 2.66 | 3.53 | 4.30 | 4.70 |
| CPI (year-end, % YoY) | 1.86 | 1.34 | 4.74 | 2.60 | 4.95 | 4.17 |
| Exports (USD bn) | 150.00 | 162.40 | 175.94 | 213.77 | 253.35 | 302.67 |
| Imports (USD bn) | 148.00 | 165.60 | 173.26 | 211.1 | 248.47 | 295.56 |
| Trade Balance (USD bn) | 2.00 | -3.20 | 2.68 | 2.70 | 4.88 | 7.11 |
| % of Export | 1.33% | -1.97% | 1.52% | 1.26% | 1.93% | 2.35% |
| Exchange rate (USD/VND) | 21,250 | 22,520 | 22,790 | 22,750 | 22,980 | 23,200 |
| Current Account Balance (USD bn) | 9.36 | 1.00 | 9.60 | 4.00 | 9.00 | 9.00 |
| Foreign reserve (USD bn) | 34.30 | 28.40 | 36.70 | 50.00 | 56.00 | 65.00 |
| Foreign reserve/imports (weeks) | 12.05 | 8.92 | 11.01 | 12.29 | 11.72 | 11.44 |
| Credit growth (%) | 14.00 | 17.29 | 18.80 | 18.00 | 18.00 | 17.00 |
| Deposit rate (VND -%) | 6.00 | 6.00 | 6.00 | 6.00 | 6.00 | 6.00 |

Source: Nikkei, Markit, Vietcap

manufacturing and the property market, but not so high as to be inflationary.

**Foreign exchange**
Vietnam succeeded in stabilising the US$ exchange rate. The national reserve has accumulated to US$52 billion (3 months of imports).

## VIETNAM BUSINESS ENVIRONMENT AT A GLANCE

**Policy towards private enterprise and competition**

- 2018–19: Reform of the state-owned sector remains slow despite some high-profile public offerings of shares in state-owned enterprises. The process of reducing red tape continues, albeit only gradually.

- 2020–22: The Committee for State Capital Management takes more ownership of the privatisation process, reducing the inherent delays caused by strong vested interests in a number of ministries. The competition law is applied more forcefully.

**Policy towards foreign investment**

- 2018–19: Restrictions on foreign investment are loosened further and tax incentives for such projects remain generous.

- 2018 onwards: Expansion of foreign ownership limit.

**The number of special economic zones grows, especially those for high-technology manufacturing**

- 2020–22: The government opens up more of the services sector to foreign investors.

**Foreign trade and exchange controls**

- 2018–19: Implementation continues of free trade agreements (FTAs) with South Korea, the EU and the Eurasian Economic Union. The Comprehensive and Progressive Agreement for Trans-Pacific Partnership comes into effect.

- 2020–22: Regional non-tariff barriers and barriers to trade in services in the ASEAN are lowered, and other non-ASEAN-related FTAs are pursued, helping to improve efficiency and business environment regulations.

**Taxes**

- 2018–19: Progress is made on improving tax collection, but inefficiencies and graft persist. Taxes are used increasingly as a tool of social policy, including through rises in 'sin taxes' and environmental levies.

- 2020–22: The tax base is broadened, but the system remains complicated. The corporate tax rate for small and medium-sized firms is gradually reduced to 15–17%, but employees' social security contribution rates continue to rise.

**Financing**

- 2018–19: Policymakers work to reduce bad debts at banks and direct lending towards high-priority sectors. Merger and acquisition activity increases. Activity in the stock market cools down after strong gains in 2016–17.

- 2020–22: Limits on the activities of foreign banks are loosened further, leading to consolidation of the banking sector.

**The labour market**

- 2018–19: Despite the tight labour market, wages remain competitive by regional standards. The urban–rural wage gap widens, while shortages of skilled labour increase. However, a relaxation of foreign-labour rules provides some relief.
- 2020–22: Productivity-adjusted wages stay low. The risk of worker unrest rises as the cost of living continues to increase.

**Infrastructure**

- 2018–19: The supply of electricity remains inadequate.
- 2020–22: The cargo sector and air travel grow rapidly. Modest improvements are made to road networks.

**Technological readiness**

- 2018–19: Demand for telecommunications services continues to rise sharply.
- 2020–22: Broadband speeds improve as government investment into the sector continues.

## Vietnam merger and acquisition market

### OVERVIEW

Global integration has been key in supporting trade and attracting FDI *(Please see Annex 1 for more information about Vietnam Integration)*. M&A activities have increased significantly: since 2012, there have been over 300 M&A deals per year, with a total value of more than US$4 billion.

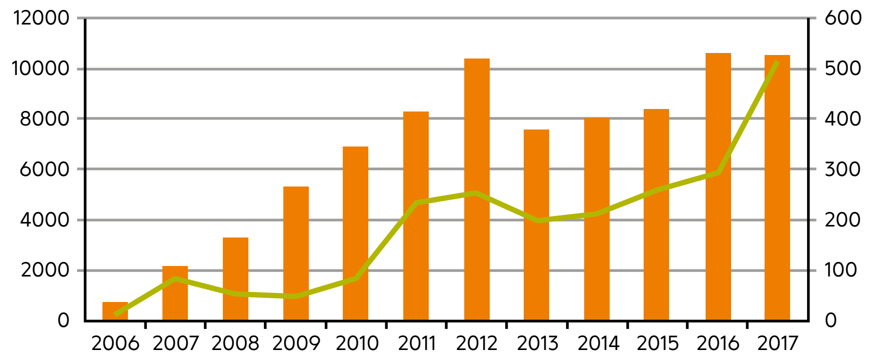
However, M&A activities incurred fragmentally, and with smaller deal sizes than other ASEAN countries. For example, Singapore's total deal value reached US$62.3 billion in 2016 and US$78.6 billion in 2017, far higher than other ASEAN countries.

By contrast, Vietnam's deal value was the smallest: the total deal value was US$5.8 billion in 2016 and US$10.2 billion in 2017 (including a large Sabeco deal, valued at US$4.8 billion); over 90% of these deals were transacted around US$5–6 million. Foreign investors continued to play a key role in significant deal sizes of US$20 and above.

**M&A in significant sectors**

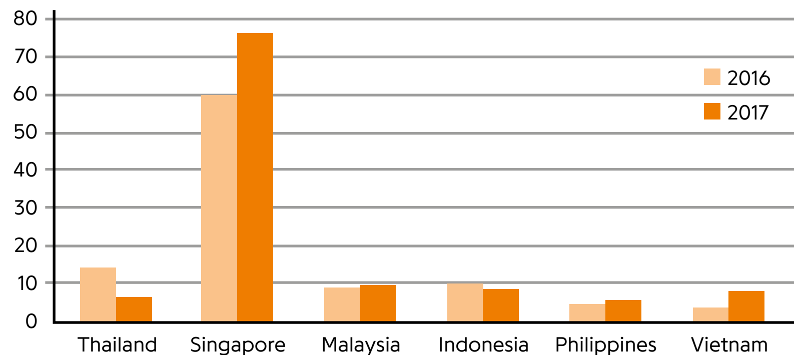
A young and increasingly middle-class population of over 94 million makes Vietnam an attractive country for investments. M&As in food and consumer products have attracted the most investment over the past 2 years: from 2017 to June

M&A activities in Vietnam, 2006–17




Source: MAF

Deal size in Asian countries, 2016–17




Source: MAF

Significant deals, 2017 to June 2018

| Investor/Buyer | Investee/Seller | % Stake | Value (US$ million) |
|---|---|---|---|
| Thaibev | Sabeco | 54% | 4,800 |
| 1GIC Private Ltd | Vinhomes | N/A | 1,300 |
| Warburg Pincus | Techcombank | N/A | 361 |
| JC&C | Vinamilk | 3% | 319 |
| KKR | Masan (Consumer goods) | 10% | 250 |
| ShinhanBank | ANZ | 100% | 240 |
| GIC Private Ltd | Techcombank | N/A | 100 |
| Sojitz | Saigon Paper Incorporation | 98% | 95 |
| EarthChemical | Á Mỹ Gia | 95% | 89 |
| Vina Capital | Ba Huan Ltd (Eggs) | 16% | 33 |
| Vinfast (Car Maker) | GM Viet Nam | N/A | N/A |

Source: MAF

Vietnam M&A real estate sector, 2016 to June 2017

| No | Buyer/Investor | Seller/Investee | % Stake | Deal Value (US$ Mil.) |
|---|---|---|---|---|
| 1 | China Fortune Land Development | Vina Capital (Dai Phuoc Lotus) | n/a | $63.6 M |
| 2 | Capita Land | Thien Duc Trading Construction | 20% | $17.9 M |
| 3 | Capita Land | Twin Peak Development & Riverview | 100% & 75% | $51.9 M |
| 4 | Hankyu Realty Co., LTD và Nishi-Nippon Railroad Co., LTD | Công ty CP Đàu tu Nam Long | 50% | $70.1 M |
| 5 | Angia & Creed | Van phát Hung (Lacasa) | n/a | $40 M |
| 6 | Keppel Land | Southern Waterborne Transport Corp | 16% | $37 M |
| 7 | EXS Capital & ACA Investment | Son Kim Land | 10% | $100 M |

Source: MAF

2018, some significant deals were reported (see table).

Investors also aggressively participated in the real estate sector, seeking to secure the 'golden' locations. The sizes were fairly big (see table).

**M&A MARKET OUTLOOK**

As Vietnam continues to restructure its economy, many financial activities require M&A support. This offers considerable opportunities, but – as with any developing market – some difficulties should be acknowledged:

- **The quality of Vietnamese enterprises is weak:** Foreign investors are mostly interested in large-scale businesses. The chartered capital of most companies listed in Vietnam is about 50–80 billion Vietnamese dong (VND), equivalent to US$2–4 million; capitalisation, about US$5–10 million.
- **Stakeholders' mindset:** Many large private companies have not escaped the mentality of selling their business, whereas foreign investors often want to take a dominant stake in it.
- **Financial reporting and information disclosure are not transparent:** This is the biggest problem affecting foreign capital attraction. At present, most Vietnamese businesses still have two book accounts, which makes investors hesitant about the accuracy of the financial figures.
- **Valuation is sometimes too high:** When meeting with foreign partners, most Vietnamese companies still expect to sell at high prices. This is a factor leading to M&A in Vietnam because the two sides cannot agree on the price.

Despite these difficulties, the M&A market has proved its lively strength. Nevertheless, the Vietnam government is gradually issuing rules and policies to regulate the financial market more closely and increase transparency. More importantly, Vietnamese enterprises have recognised the benefits of M&A and are adapting to meet investors' demands. As a consequence, the Vietnam M&A market is expected to rise strongly in the coming years.

According to a Vietnam M&A Forum (MAF) report, the value of M&As in Vietnam in 2017 reached US$10.2 billion, the highest level ever and up 175% over 2016. In the first 6 months of 2018, the total value of M&A deals in Vietnam reached US$3.55 billion (equivalent to 155% of the same period in 2017).

MAF forecast that M&A value in 2018 will decrease compared to 2017, because the Sebaco deal value of UD$4.8 billion in 2017 was a unique case. Under this scenario, M&A value in Vietnam is expected to reach US$6.5–6.9 billion (equivalent to a 15.3% increase compared to 2017 if Sabeco is excluded; equivalent to 58.8% of M&A value in 2017).

Thus, in a prudent scenario, Vietnam's M&A market value will remain at over US$5 billion for the 2015–18 period. However, maintaining the new heights of the market will require large-value deals as well as stronger moves from governments and enterprises.

For 2018 and beyond, M&A deals will continue to focus on consumer goods, retail and real estate. In addition, the fields of telecommunications, energy, infrastructure, pharmaceuticals and education are expected to contribute significantly to M&A activities in Vietnam in the coming period.

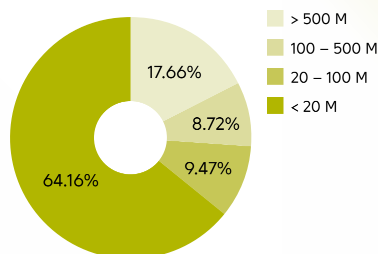
In coming years, we can expect larger-scale deals, especially divestment of large equitised state-owned enterprises and the involvement of foreign investors.

### Investments and M&A for small and medium enterprises: open opportunities

Given that small deals represent over 60% of Vietnam's M&A market, the government has recently produced guidance to support SMEs. Decree 39/2018/ND-CP of 11 March 2018 defines SMEs as those having fewer than 100 employees and total annual revenue up to VND 300 billion (US$12.8 million) or total capital no more than VND 100 billion (US$8.5 million).

Of the 561,000 companies operating in Vietnam by the end of 2017, over 60% are SMEs. As the country enters into FTAs, most of SMEs will need capital, marketing and

## Vietnam M&A deal sizes, 2016 to June 2017




Source: MAF

## Vietnam M&A deal sizes in 2016 –June 2017

| Deal Size | % Weight | Deal Value (US$ Mil) | Number of Deals | % Weight |
|---|---|---|---|---|
| > US$500 M | 17.66% | 1,024 | 2 | 0.38% |
| US$100 – US$500 M | 8.72% | 506 | 3 | 0.57% |
| US$20 – US$100 M | 9.47% | 549 | 11 | 2.08% |
| < US$20 M | 64.16% | 3,721 | 514 | 96.98% |
| | **100%** | **5,800** | **530** | **100%** |

Source: MAF

specialist expertise to survive fierce competitions with local and foreign companies. However, few funds or investors are interested in such small-sized value deals. This offers great opportunities for investment and M&A in SMEs, especially when big or blue-chip companies are becoming more expensive.

As a natural development, some advisory firms and brokers have organised fund-raising activities for SMEs. The deal size varies from US$50,000 to US$2 million. And this trend is quickly spread over the whole country, especially crowd funding and start-up funding. Several private equity funds – like VIG, Mekong Capital or Viet Capital – have started paying more attention to start-ups or SMEs, to whom their financial and management support will lend a significant boost.

Vietnam's SMEs grow from family businesses and can encounter business management problems once they reach a certain size or level. Because securing long-term capital is always a challenge, they rely heavily on banks, which offer little help with overall strategy/ management issues. Therefore, local companies are always keen to attract strategic investors.

A typical success story of investment in Vietnam is MEF II (a fund managed by Mekong Capital), who in 2007 invested US$3.5 million in MobileWorld Investment Joint Stock Company (MWG) for a 35% stake. By end of 2017, the cumulative net proceeds from the sale of MEF II's MWG shares and dividends received was US$199.4 million[1].

## ANNEX 1
## Global integration has been key support for trade and attracting FDI

| No | FTAs | Status | Launched | Signed | Effective |
|---|---|---|---|---|---|
| 1 | ASEAN Free Trade Area (AFTA) | Signed, in effect | | | 1996 |
| 2 | Vietnam-Japan Econnoimc Partnership Agreement | Signed, in effect | | Dec 2008 | Oct 2009 |
| 3 | Vietnam-Chile Free Trade Agreement | Signed, in effect | | Nov 2011 | Jan 2014 |
| 4 | Vietnam-Laos Free Trade Agreement | Signed, in effect | | Mar 2015 | Jan 2016 |
| 5 | ASEAN-India Comprehensive Economic Cooperation Agreement | Signed, in effect | | Aug 2009 | * |
| 6 | ASEAN-Australia and New Zealand Free Trade Agreement | Signed, in effect | | Feb 2009 | Jan 2010 |
| 7 | ASEAN-Korea Comprehensive Economic Cooperation Agreement | Signed, in effect | | Aug 2006 | ** |
| 8 | ASEAN-Japan Comprehensive Partnership | Signed, in effect | | Apr 2008 | Dec 2008 |
| 9 | ASEAN-People's Republic of China Comprehensive Economic Cooperation Agreement | Signed, in effect | | Nov 2002 | *** |
| 10 | Vietnam-Korea Free Trade Agreement | Signed, in effect | | May 2015 | Dec 2015 |
| 11 | Vietnam-Eurasian Economic Union | Signed, in effect | | May 2015 | Oct 2016 |
| 12 | ASEAN Economic Community (AEC) | Signed, in effect | | | Dec 2015 |
| 13 | ASEAN-Hong Kong, China Free Trade Agreement | Signed | | Nov 2017 | 2019F |
| 14 | Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) | Signed | | Mar 2018 | 2019F |
| 15 | Vietnam-European Union Free Trade Agreement | Negotiations completed | | 2018F | 2019F |
| 16 | Vietnam-European Free Trade Association (EFTA) | Negotiations launched | May 2012 | | |
| 17 | Regional Comprehensive Economic Partnership (RCEP) | Negotiations launched | May 2013 | | |
| 18 | Vietnam-Israel | Negotiations launched | Dec 2015 | | |

(*) Trade (Jan 2010), Services & Investment (Jul 2015) (**) Trade (Jun 2006), Services (May 2009) & Investment (Jun 2009) (***) Trade (Jul 2005), Services (Jul 2007) & Investment (Feb 2010)

Source: VCCI

1. 'Vietnamese PE Mekong Capital completes exit from MobileWorld', Reuters, https://www.reuters.com/brandfeatures/venture-capital/article?id=26390

Vietnamese companies like MWG offer exciting possibilities: with good business models and a market share that can be easily scaled up, SMEs just need the right backing to realise their full potential.

Although investors in SMEs may encounter difficulties like those described above for M&A, SMEs offer the advantages of being flexible and adaptable: the decision-making process often involves just one or two people, rather than requiring a meeting as a large corporate often does. With simpler structures for their stakeholders, personnel and capital, SMEs can often achieve results more easily than big firms.

## Conclusion

Vietnam has joined several FTAs that encourage trade with neighbouring countries. This, together with its stable economic indicators, makes Vietnam an attractive destination for investors.

According to SSI Research, Vietnam's stock market can be upgraded to emerging market status in 2020 by MSCI. Once Vietnam is classified as an emerging market, it will attract more funds, and in turn the more active investment market will also encourage investors.

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# A brief introduction to Taiwan's individual income taxation

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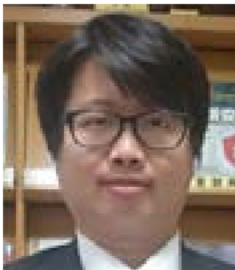

## General overview

Taiwan's individual income taxation system is based on residency and territorial principles. Foreign nationals, under the residency conditions stated below, will be considered as tax-resident taxpayers liable for local-source income like Taiwanese nationals.

Regardless of the exceptions provided by the alternative minimum tax (AMT), residents and non-residents are tax liable for income generated in Taiwan (i.e. territorial principle).

The income, which is derived from personal services provided in Taiwan, will be subject to Taiwanese income taxation regardless of the employer's residency status. However, if the service income is paid to a non-resident with <90 days of stay in Taiwan, the same will not be subject to withholding taxation when the payments are made by a non-resident employer.

## Personal income tax

### Personal residency

Determining residency status is crucial for individual taxation purposes. Individuals who have a registered domicile in Taiwan (e.g. a long-stay expatriate), or who reside in Taiwan for >183 days during the tax year, are considered as tax residents. In other words, an individual who stays <183 days and has no registered domicile in Taiwan shall only be subject to withholding tax for local-source income.

### Personal income tax rates

Taiwan imposes a progressive tax bracket on residents for their personal comprehensive net income. Every resident is required to file income tax return in May for net income earned during the last calendar year.

The current system's ceiling tax rate for 2018 is 40%, since the recent tax reform abolished the 45% ceiling rate. The applicable tax bracket ranges from 5% to 40%.

Non-resident individuals who have Taiwan-source income will be subject to withholding tax ranging from 15% to 21%. Withholding rates vary from different sources. For example, 21% is applicable for dividend received and 20% for interest and royalty payments, if no double tax treaty exists.

Personal income tax rates for 2018

| Taxable income (US$) | Tax rate |
|---|---|
| 0–18,000 | 5% |
| 18,001–40,000 | 12% |
| 40,001–80,000 | 20% |
| 80,001–150,000 | 30% |
| 150,001 and above | 40% |

In addition to personal income tax, Taiwan imposes an AMT with a flat rate of 20% on tax residents for selected items of income, with an aggregate threshold of US$220,000. When the foreign-source income is higher than US$33,000, the entire income is included in the AMT base.

### Personal dividend taxation from 2018

With the recent tax reform, Taiwan ended its dividend imputation system and introduced a 28% flat tax rate for dividend income distributed to tax residents, starting from 1 January 2018. Foreign personal shareholders not residing in Taiwan will be subject to 21% withholding tax. However, pursuant to 32 tax treaties, the dividend withholding rate could be lowered to just 10%.

## Corporate income tax

In Taiwan, CIT is levied upon both profit-seeking and non-profit enterprises, which are categorised into those with head offices in Taiwan and those that have head offices outside but generate income from Taiwan ('foreign enterprises').

In accordance with international tax principles, foreign enterprises are further divided into two kinds: with or without permanent establishment (PE).

**CIT rates**

Pursuant to the recent tax reform, CIT is levied upon corporate net income over US$4,000 with a flat rate of 20% starting from 2018 (previously 17%).

Besides CIT, Taiwanese enterprises and foreign enterprises with PE are subject to the AMT on basic net income, which includes exempted incomes.

**Overview of corporate tax system**

Resident enterprises that are incorporated in Taiwan are taxed on their worldwide income (the 'residency principle'). Foreign enterprises with a fixed place of business or business agent in Taiwan will be taxed on their Taiwan-sourced income and are obliged to file tax returns.

The enterprises are taxed on their net income, which is calculated after deductions from gross revenues. The CIT system also provides exemptions on certain items, such as capital gains from securities and futures transactions.

**Special tax treatment for cross-border e-commerce**

In May 2017, Taiwan adopted a simplified VAT regime for cross-border e-commerce providing digital services to local consumers. This was complemented in early 2018 by a new simplified CIT regulation: foreign e-commerce enterprises that have no PE but derive income from Taiwan through sales of digital services must now pay VAT and CIT calculated according to the percentage of sales revenues from Taiwan.

**Taxation on real-estate transactions**

Since 2016, real-estate transactions are subject to a special CIT regime. Land and buildings purchased after 2016, and those purchased on/after 2 January 2014 but held for <2 years, impose regular income tax of 20% on Taiwanese corporate taxpayers and 35% or 45% on foreign enterprises without PE in Taiwan.

**Thin capitalisation rule**

Interest expenses caused by inter-company loans are also deductible with the limitation of debt/equity ratio of 3:1. This 'thin capitalisation rule' is applicable only to enterprises. Banks, financial holding companies and other financial institutions are excluded.

**Tonnage system**

Shipping companies can switch to a tonnage tax system, whereby they are taxed according to their net tonnage of fleet. Once a company chooses to be taxed under this system, it cannot re-base its taxation system within 10 consecutive years.

**Fiscal year, CPA certification and loss carry-forward**

The fiscal year starts on 1 January and ends on 31 December, but an enterprise can apply to change these dates. Normally, the CIT return should be filed no later than 5 months after the fiscal year end.

Some special industries and limited companies with a revenue exceeding US$3.33 million must have their tax returns certified by a certified public accountant (CPA). CPA certification of the CIT return is a prerequisite of several tax advantages, such as loss carry-forward for 10 years.

**Consolidated returns for group companies**

Pursuant to the Corporate Merge Act (effective since 2002), groups with a parent company holding >90% of subsidiaries' shares for 12 months in a year can file for consolidated tax returns, which may facilitate the tax assessment procedure.

**Branch and subsidiary**

Foreign enterprises can register a branch office or incorporate a subsidiary company for doing business in Taiwan. The branch office shall pay CIT in accordance with Taiwan-sourced income minus costs and expenses. Its after-tax earnings will not be subject to further withholding tax when distributing earnings back to the foreign parent company. The dividends withholding for a subsidiary company is 21% from 2018.

**Anti-tax avoidance through the rule of substance over form and arm's length principle**

According to the Taxpayer's Right Protection Act (effective since the end of 2017), tax authorities may conduct assessments on the substance of transactions to determine whether there seems to be an aggressive tax practice. The arm's length principle applies to controlled transactions between related parties. Taiwan has adopted the transfer pricing rules, practice, and documentation requirements in accordance with international (BEPS) standards.

**Controlled foreign company regimes**

A new CFC regime was announced in 2016 but is not yet in force. According to the current system, profits generated by Taiwanese companies' offshore subsidiaries are not subject to CIT until the income has been repatriated to Taiwan as dividends. When implemented, the new regime will require no substantial activities, low tax country (effective CIT rate <14%) and >50% control of the offshore subsidiary.

**Place of effective management**

The PEM rule is also not yet in force, but when implemented it will deem a foreign company as having its head office in Taiwan and subject

*"As of 2018, Taiwan has signed 32 tax treaties with different countries. Major treaty partners are in Europe and Asia – such as France, Germany, the Netherlands and Japan"*

to CIT if any of the following are located in Taiwan: decision making, record keeping and maintenance, or actual operating.

**Withholding tax**

Foreign enterprises with no PE must pay withholding tax for income generated in and received from Taiwan. Withholding rates vary depending on the nature of payment (e.g. 21% for dividends, 20% for ordinary interest).

**Taxation and tax credit of Taiwan-resident corporation's foreign operations**

Enterprises that have their head office in Taiwan are taxed on their worldwide income ('residency principle'). The income tax paid to foreign jurisdictions for the offshore operation can be recognised as a tax credit for Taiwan CIT if the foreign tax paid is notarised by Taiwan's foreign consulate. However, the deductibility of foreign tax credit is limited to the extent that such deduction shall not exceed the amount of tax which, computed at the applicable domestic tax rate, is increased in consequence of inclusion of its income derived from abroad.

**Tax incentives**

To attract and encourage foreign investment, Taiwan offers various tax incentives to certain industries and lines of business; for example, R&D expenditures can be credited against the income tax payable, with a limitation of 30%.

**Alternative minimum tax**

The Income Basic Tax Act (effective since 2005) imposes AMT on resident and foreign enterprises with PE in Taiwan if they have tax-exempt income or their annual basic income exceeds US$16,000. AMT obligations arise if the enterprise's basic income is greater than its regular income.

**Taxation of shareholders**

Domestic shareholders

With the recent tax reform, Taiwan ended its imputation system: dividend distribution among resident companies is tax exempt, but companies must pay tax on foreign-sourced dividend income. Foreign taxes paid to foreign governments may be credited against their CIT liabilities, and exemption is provided for capital gains from the sales of Taiwanese securities and futures (although these must be calculated under AMT).

Foreign shareholders

Foreign shareholders are subject to withholding tax of 21% on dividend income, although this can be reduced to 10% in case of applicable tax treaty.

**Double taxation agreements**

As of 2018, Taiwan has signed 32 tax treaties with different countries. Major treaty partners are in Europe and Asia – such as France, Germany, the Netherlands and Japan. The concepts and articles of the signed treaties are quite similar and compatible with the OECD Model Tax Convention; they mostly cover individual and corporate taxation. These treaties provide reductions and exemptions – for example, withholding tax rates on dividends, royalties and interest can be reduced by around 50%, depending on the agreement.

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# India–UK social security arrangements

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**Here, we propose the introduction of a social security agreement that would help balance what the UK has to offer and put Indian inward investors on an equal footing with US and other international investors who benefit from a full social security agreement.**

## The case for a social security agreement

India is one of the largest investors into the UK, having set up 127 new projects, safeguarded 7,645 existing jobs and created 3,999 new jobs in 2016–17. Over 800 Indian companies in the UK, with consolidated revenues of £47.5 billion, employ nearly 110,000 people. Indian employees on secondment to the UK also contribute in significant measure to the UK economy.

The largest workforce on secondment to the UK from India is from the technology services sector. Typically, these Indian companies have branches or subsidiaries in the UK and use the Tier 2 intra-company transfer (ICT) route to obtain certificates of sponsorship for the employees on secondment.

In many cases, Indian employees working in the UK may be required to contribute towards both the Indian and the UK social security schemes. Temporary Indian workers in the UK have a limited exemption from paying social security, even though they have restricted access to public funds and are unlikely to work in the UK for long enough to accrue any state pension entitlement.

If India and the UK enter into an agreement, then Indian employees may be able to claim exemption from social security contributions in the UK by obtaining a certificate of coverage (CoC) from the Indian Provident Fund office. Indian industry is therefore keen to have a sustained dialogue to progress on a social security agreement between India and the UK.

## The issue: National insurance contributions and exemptions

Each employer behaves differently but, until April 2017, the ICT route had a 'short-term' category that allowed Indian employers to second employees to the UK for a period of up to 12 months. This was a popular category to use for secondees to the UK. For UK national insurance purposes, this generally resulted in no employee's or employer's NI being due as the 52-week exemption applied in most cases (under s.145 (2) Social Security (Contributions) Regulations 2001).

From April 2017, the short-term category route was closed to new applicants, which has served to highlight an existing problem for longer-term secondees. Secondees who applied for certificates of sponsorship after this date would generally have come with an expected stay of >12 months so would, at some point during their secondment to the UK, be liable for NI. Once they exceed the initial stay of 52 weeks, they lose their exemption from NI, making the employer and employee liable to Class 1 primary and secondary contributions, in the same way as a UK local hire, given that there is no social security agreement between India and the UK.

The minimum period of NI contributions to gain entitlement to a state pension is 10 years, which an Indian employee on a Tier 2 ICT visa is unlikely to meet as the maximum length of the visa in most cases is 5 years (or in certain cases, 9 years, if the salary paid is £120,000 or more). The employer will incur a cost of 13.8% and, once NI is being

paid, will also be subject to the apprenticeship levy of 0.5%; so the total cost to the employer would be 14.3%.

### What difference would a social security agreement make?

A social security agreement between the UK and India would potentially provide three benefits to Indian workers on secondment to the UK:

- **Avoidance of double social security contributions:** Firstly, it would provide an exemption from NI in the UK for a period longer than the existing default 52 weeks on the basis that the employee and employer continued to make contributions to the social security system in India (provident fund, superannuation and/or gratuity). This would increase the social security burden in the first year as, under the current rules, there are often no contributions being made in the UK or India but would provide a saving in the second and later years where it is possible that contributions will be made in both the UK and India on the same element of salary.

- **Aggregation of contribution periods:** Secondly, a social security agreement would normally provide for the totalisation of the period of coverage in the home country (India) and the host country (the UK). The period of contribution in one country will be included in the period of contribution in the other country in order to determine eligibility for pension benefits under Indian or UK social security (except for periods of overlap between the two countries).

- **Exportability of benefits:** Finally, a social security agreement would normally include an 'export of benefits' clause that would allow the UK authorities to remit any state pension entitlement accrued in the UK directly in India to Indian employees once they have returned.

*"A social security agreement between the UK and India would potentially provide three benefits to Indian workers on secondment to the UK"*

### An insight into government negotiations

India has raised the issue of a social security agreement with the UK several times in the past. However, progress has been slow due to significant differences in the structure of the two systems and need for parity in reciprocal arrangements.

Most recently, during the January 2018 UK visit of Shri Suresh Prabhu, India's Minister for Commerce and Industry, this was discussed with his counterpart Dr Liam Fox, Secretary of State for International Trade, at the India–UK Joint Economic and Trade Committee meetings.

The NI exemption currently offered to Indian nationals is 52 weeks, while the exemption for several other nationalities can be between 3 and 5 years, depending on whether they belong to a

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European Economic Area country or a country with which the UK has a reciprocal agreement (RA) or double contribution convention (DCC). This will not include all provisions, such as totalisation and export of benefits.

In this context, in the case of a business employing a US worker on secondment to the UK, it would be possible for the US worker to obtain a CoC under the social security agreement, which would give a 5-year exemption from NI on the basis that continued contributions are already being made in the USA. Therefore, an employer of Indian nationals on secondment to the UK is at a disadvantage, compared to an equivalent employer of US nationals. This has a bearing on ease of doing business and business competitiveness for Indian companies in the UK, given that India is one of the largest inward investors to the UK and will become an increasingly important trading partner in a post-Brexit world.

Not all social security agreements include totalisation and export of benefits clauses, so it would be a matter of negotiation between countries whether a full or partial agreement is entered into. By way of example, the India–Belgium social security agreement, which the Government of India has announced to be effective starting 1 September 2009, includes all three elements of the model agreement and provides an exemption for 60 months (5 years).

## Policy action

Changes to the immigration rules with the abolition of the short-term ICT category of visa and the introduction of the skills and immigration health surcharge has made the UK less competitive for Indian businesses wishing to expand to the UK.

The introduction of a social security agreement would help to balance what the UK has to offer, putting Indian inward investors on an equal footing with US and other international investors who benefit from a full social security agreement that gives a 5-year exemption from UK NI.

We strongly recommend prioritising a full social security agreement for a 5-year period; this would compensate for abolishing the most popular ICT visa category period and put India in the same position as the top foreign investors in the UK.

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# Recruiting and retaining audit talent

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**Chun Wee Chiew was a guest speaker at Morison KSi Asia Pacific Conference 2018 in Da Nang, Vietnam, where he delivered a presentation on 'Professional Accountants – The Future: Generation Next'.**

*A study of audit staff in Asia Pacific reveals dissatisfaction and lays out how firms can recruit – and retain – talent. ACCA's Chiew Chun Wee explains.*

It's not at all uncommon to find external auditors in many parts of Asia Pacific putting in long hours at work, and the profession is generally not expected to enjoy a great work–life balance. In a few extreme cases, young professionals have reportedly died of overwork.

As a result, the attractions of an audit career are not necessarily obvious to the new generation of talent with a different outlook on life.

The motivation and quality of audit staff fundamentally affect audit quality, so talent management understandably ranks high among audit firms' priorities.

It was against this backdrop that ACCA undertook the largest and most in-depth survey of audit staff in three Asia Pacific countries in collaboration with the audit regulators in the respective markets – the Accounting and Corporate Regulatory Authority (ACRA) in Singapore, the Audit Oversight Board (AOB) in Malaysia, and the Securities and Exchange Commission (SEC) in Thailand. The results of the three surveys provide audit practices with cross-firm and cross-market comparisons. They also offer a blueprint for actions for audit firm management for shaping their talent attraction and retention strategy.

## Highly valuable career

In all three markets, staff see an audit career as valuable in professional development because of the extensive learning experience it offers. Auditors are given a 'licence to be nosey'. Their work gives them an in-depth appreciation of the inner workings of their clients, and they rapidly acquire business knowledge in a range of markets and industries, identifying best practices as well as weaknesses in process and controls. In addition, audit staff clearly enjoy a great sense of comradeship with their colleagues ('together, they suffer and reap the fruits of labour!'). In fact, in Malaysia, 86% of external auditors who responded to the survey said they enjoyed the nature of audit work.

Yet only a low proportion of respondents said they were satisfied with their career in audit, and many intend to leave in the near future. In Singapore, for example, only 38% of staff were satisfied, with 65% planning to move on within 3 years. Many want to see fundamental changes.

## The whys

Much of the dissatisfaction stems from workloads outpacing rewards. Staff's passion for audit must compete with the frustrations of work–life imbalance. Respondents noted that their high workload was clearly and strongly connected to clients' need to strengthen their financial reporting capabilities, and felt that fees paid should reflect the true value of an audit. Competition among audit firms is fierce, reducing auditors' bargaining power. The knock-on effect is that audit clients sometimes get away with producing substandard work. This ultimately costs auditors time and effort and significantly impacts their

productivity, motivation and job satisfaction.

There is no silver bullet for this deep-rooted issue. Audit staff believe – and we agree – that the entire reporting ecosystem of preparers (clients), regulators and accounting industry at large needs to coordinate and work with the audit profession to raise the quality of reporting. And that game raising needs to start from the source – the preparers.

From the perspective of the audit firms, engagement management needs to enforce the ethics of the profession up to the highest level.

Constant communication between an audit firm's engagement management and its clients is crucial to eliminate obstacles and prevent misunderstandings. Encouraging clients to improve their accounting practices and their understanding of financial reporting standards will expand clients' competencies and raise the quality of financial reports. Audit staff also crave even greater involvement and leadership from engagement management throughout audits.

### Their greatest assets

A common slogan of audit firms is that their people are their greatest assets. The assets think differently. When asked if they thought their superiors would try to understand their concerns and work to retain them if they decide to go, only 62% in Malaysia and 56% in Singapore answered 'Yes'.

Audit firms need to move beyond slogans and take concrete steps to show they value staff and are genuinely concerned about their well-being. Well-received initiatives include flexible working arrangements, sponsorship of further studies and professional qualifications, as well as recreational corners, bring-your-child days and gym access.

*"Other initiatives that are seldom available but yearned for by staff are 360° feedback and more structured and frequent job rotation within a firm's different divisions"*

The outsourcing of administration and routine tasks would enable audit staff to focus more on core, significant tasks. It would reduce working hours, raise productivity and alleviate work pressures. Other initiatives that are seldom available but yearned for by staff are 360° feedback and more structured and frequent job rotation within a firm's different divisions. However, nothing is more critical than allocating jobs equitably and providing adequate resources for each assignment.

One major bank was recently reported to have put in place a 'no work on Saturday' rule for its junior bankers. This kind of move sends out an unmistakable message from the top that long hours are not encouraged, and that top management, in a word, cares.

### Have wings, will fly

In today's globalised economy, a clear premium is attached to international experience, and audit

staff get that opportunity by going on secondments. Secondment benefits include diversified work experience in terms of culture, working styles and an entirely different set of client portfolios. Some survey respondents thought a prolonged overseas stint would improve their communication skills, broaden their horizons, and enhance their CVs.

In Singapore, almost all the male respondents under the age of 25 were keen on an overseas posting. In Thailand, 75% said they would take up such an opportunity, although some staff at mid-tier firms did not see such opportunities as being available to them.

Firms would be better able to give employees what they want and to enhance their own attractiveness to talent by working more closely with overseas affiliated offices to explore more international staff exchange, including shorter-term arrangements.

Only one-fifth of respondents across all three markets said they aspired to become a partner. The proportion dropped to one-tenth for female respondents in Singapore and Malaysia. The female/male ratio of audit staff is roughly 6:4 from entry to managerial level, but at partner level changes hugely to about 2:8.

The relatively low proportion of audit staff aspiring to make it to partner could be in part a consequence of the profession's work–life challenge. However, for those with the capability and will to attain the Holy Grail of the audit profession, firms should address what respondents saw as unclear partnership pathways and admission criteria. As regards the gender imbalance at the top, firms should consider whether their work arrangements are conducive to family commitments (a factor that is equally applicable to male staff). Some respondents suggested showcasing female role models in a more pronounced manner and offering more targeted mentoring to earmarked female candidates.

### Communication

Audit firms need to create an engaging and open culture where employees have the confidence to talk about their well-being as well as career satisfaction. They need to ensure that staff concerns are dealt with transparently so that even if they are not completely satisfied, staff know those concerns are not merely swept under the carpet.

The talent issues highlighted in the survey reports provide a good starting-point. Talent management policies need to progress with time and be subject to rigorous field-testing to ensure they are fit for purpose. All efforts will pay dividends in time in the form of reduced staff costs and enhanced audit quality.

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# Surviving those 'curveball' questions: Think On Your Feet® has answers for you

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**Roshini Ganesan was a guest speaker at Morison KSi Asia Pacific Conference 2018 in Da Nang, Vietnam, where she delivered her keynote speech, 'Think On Your Feet®'. Think On Your Feet® is an internationally recognised workshop run by the author and can be run as a 1- or 2-day event.**

### Why do people hate you?

How would *you* answer this question?

My guess is that you would say that your answer would be influenced by

- the tone of voice in which it was asked;
- the context; and, of course,
- who was asking the question.

Setting aside these considerations, would you say this is ever an easy question to answer? Could you have anticipated a question like this? Where would you even start to respond?

This is what I mean by a 'curveball' question. You know the type: they come out of nowhere and surprise you, sometimes creating an awkward silence as you struggle to say something… anything. And the emotions you feel are not easy or pleasant to deal with. It's the type of question that can have you start speaking before processing the question – an approach that often ends up with you slapping your forehead as you walk away, when your brain comes up a hundred different options of what you *could* have said instead. Unfortunately, all the brilliant answers that come to you, come a little too late. You can blame all this on that amygdala of yours! The part of the human brain that is popularly known as the 'lizard brain', which perceives curveball questions as threats – which is why in the face of such questions we either fly, fight or freeze.

Coming back to the question 'Why do people hate you?' – this was a real question asked of former President of the United States, Barack Obama, at a town hall event. The event was televised nationally, and went viral internationally too. Now, I should mention that it came from a cherubic-looking fifth-grader; so there was nothing contentious or ill-intentioned – just a sincere question as to why people seemed to hate him when 'everyone is supposed to love you … and God is love'. You could argue that, since the question came from a kid, this was not a high-stakes situation for the president: there wasn't much to lose, and nothing much to gain. Well, he is the president, and everyone is watching and listening; so how he answers this seemingly innocent question is important. *It's always high stakes when you are the President.* Watch how he responded here: https://youtu.be/plhlm2-ZkYQ.

Now, while we may not be caught on camera or have our responses televised on national TV, most of us face similar high-stakes situations too. Sometimes it is in the context of selling our service or an idea, defending a decision we have made or justifying a course of action. And this can happen in meetings with our clients, during Q&A after a presentation or even when we meet people at a networking event. *How we answer can have an impact on our image, our credibility, our branding.*

So, knowing how to pitch those curveballs when they come at you, is a very important skill to have. Allow me then, to share some insights from TF® and from my own personal experience dealing with more than a few curveballs. I will do this by

answering three typical questions I get asked about this.

### What's your advice on what I should do if I get 'brain-freeze'?

**Press PAUSE, please!** Remember, this is common – and often, due to your amygdala being hijacked, creates a desire to flee, fight or freeze. As the first two are non-options when we are managing impressions at work, our brain defaults to the 'freeze' option. We do know, however, that this is temporary – 6 seconds, to be exact, according to Joshua Freedman, author of *At the Heart of Leadership: How to Get Results with Emotional Intelligence* (2012). So, your best option is to buy time so that your thinking brain can get back into gear.

In TF® we teach this as one of the strategies in bridging. You can buy time by:

- Asking questions to clarify or to get more specific on the question asked
- Asking for the question to be repeated (where appropriate)
- Ask for an example of what is meant.

You see, it is not that you don't know the answer – just that you need the thinking brain to function for you to access all that wonderful data that you have stored in your mind. Buying time elegantly can help you do this.

### I have too much to say and don't where to start – what then?

**Think in threes.** When you get a question like 'Why should I choose you over the competition?' or 'Why do you have to increase your rates?', giving a one-line or one-point answer may not be substantial enough for some of your clients. Or perhaps you only have one answer – it's about the value you bring; well, you still need to demonstrate that claim with supporting points that are relevant and acceptable to the client. The recommendation is: stick to the rule of threes. If someone asks you 'Why should I use your services instead of the closest competitor?' and you share only one reason, it may sound too weak. However, if you share 10 reasons why, the person listening may regret asking you the question, or worse still, you will leave them bored or irritated. Three points, though, gives just enough weight to an answer where you're making a case for yourself, your service or your organisation.

### What if I really don't know the answer?

**Honesty is the best policy.** If you do not know the answer, then try what has always worked for me: 'fessing up to the fact that I don't have the details to hand. I then assure my questioner that I understand that what's being asked is an important issue or question to address. I make a commitment to finding out the answer and getting back to them. I am careful to be specific about exactly when this will happen – date and time – and how they will get the information, e.g. via email, by telephone or in person.

My tip here would be to always walk into every meeting, every presentation and every negotiation assuming you are going to have a difficult audience. This will help you anticipate possible difficult questions that may come up. Thinking through answers that would be appropriate and acceptable to the other party is a sure-fire way of being prepared.

Having to cope with curveball questions can be unnerving, but with some practice using the structures taught in TF® and combining them with bridging techniques, the experience need not be unpleasant. In fact, the ability to change and manage the way you answer such situations will give you a newfound confidence that you can handle almost any question or comment – even curveballs – that may come your way.

*"Having to cope with curveball questions can be unnerving, but with some practice using the structures taught in TF® and combining them with bridging techniques, the experience need not be unpleasant"*

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*A 'curveball', derived from baseball terminology, here means 'something unexpected, surprising, or disruptive'.*

# Failed corporate governance as the handmaiden of financial fraud

*By Barry Jay Epstein,*
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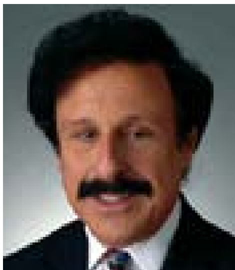

**Barry Jay Epstein was a guest speaker at Morison KSi Asia Pacific Conference 2018 in Da Nang, Vietnam, where he delivered his lecture on 'New Standards and Fraud Update'.**

Financial reporting frauds (also called management frauds) have become endemic, with huge losses being inflicted upon shareholders, creditors and others. Some of the most infamous frauds of the past two decades – Enron, WorldCom, Satyam, Olympus, Toshiba and Parmalat being a small sample – have implicated the same key concerns. These include the deviant 'dark triad' personalities of 'C-suite' executives; failures by outside independent auditing firms; and gross inattention by those charged with corporate governance, the board of directors or audit committee members. Here, we examine the failure of corporate governance.

Corporate governance is a set of rules, practices and processes used to direct and control a company. It involves balancing the interests of a company's stakeholders such as management, shareholders, suppliers, customers, financiers, government and the community. Moreover, it is essential for the success and sustainability of the business over time. When the set of rules and processes that form the governance mechanism of a firm are ineffective or fail, this can have disastrous consequences for a business.

For public companies, a board of directors (some or all of whom must generally be independent of management) is the primary body responsible for governance, and discharging that duty requires an active and engaged group of individuals experienced in business and financial reporting. Some of the most notorious frauds have occurred at entities having boards made up of well-known or prominent persons – even former high-ranking government leaders – who were seemingly solicited for the sole purpose of providing 'window dressing' to assure stakeholders of the promoters' respectability. Such directors were commonly allowed or even encouraged to give little or no real attention to the operations of the businesses they were ostensibly overseeing.

One example: the board overseeing Lord Conrad Black's newspaper empire included, among other luminaries, a highly respected former Illinois governor and the fashion-designer wife of a top private equity fund founder. One of the board meetings of this US-based company was actually held in the British prime minister's residence, where a ceremonial lunch took precedence over business discussions – all designed to keep the star-struck board members from delving into the mundane financial data or operational decisions of the management, some of whom were later convicted of criminal offences. At trial, many of the heedless board members claimed to have merely 'skimmed' the company's fraudulent financial information – which prompted a news report facetiously urging the creation of a new Olympic sport, 'synchronised skimming'. Needless to say, those neglectful board members were not invited to serve on other companies' boards, and their respective careers went into eclipse.

In another case (Enron), the board and its audit committee even included a highly respected auditing expert – a long-time college professor and textbook author – as well as other prominent individuals. Here too, the 'honour' of service

*"Governance failures don't evolve overnight, and there are several warning signs that should be noted to avoid such failures"*

on the board of a top corporation (according to the famed Fortune 500 listing, ranked seventh largest shortly before massive fraud was uncovered) dazzled those directors, and this, coupled with the apparent skills of, and aura of mystique attributed to, the company's top management, served to mesmerise those board members so that they totally abdicated their duties.

Governance failures don't evolve overnight, and there are several warning signs that should be noted to avoid such failures. These are often found to include:

- Ineffective governance mechanisms – e.g. lack of board committees, or committees consisting of only a few members or just one member
- Non-independent board and audit committee members – e.g. where a CEO fulfils multiple roles in various committees
- Management that deliberately undermines the role of the various governance structures by circumventing the internal controls and making misrepresentations to auditors and the board
- Inadequately qualified members – e.g. audit committee members not having appropriate accounting and financial reporting qualifications or experience to analyse key business transactions, family members holding board positions without appropriate knowledge or qualifications
- Ignorance or inattention by regulators, auditors, analysts, etc, to the financial results and red flags.

In some jurisdictions legislation has been enacted, such as the Sarbanes–Oxley Act of 2002 in the USA, which has been designed to prevent governance failures by increasing the exposure of errant directors to civil and even criminal liability. For example, in the USA, board members must obtain 'certifications' from the CEO and CFO regarding the absence of fraud and the effectiveness of internal controls over financial reporting functions. These requirements largely rely on an interesting psychological phenomenon: that many would-be criminals will hesitate when asked to formally acknowledge their probity, even as they demonstrate little aversion to spoken falsehoods to board members, auditors and even government overseers.

The widely reported US$1.47 billion failure of Indian computer services giant Satyam in 2009 is one example of a large-scale, long-running financial reporting fraud (and asset theft) that implicated not only audit failure, by renowned international firm PwC, but also gross neglect of duty by the board of directors.

Satyam (ironically, the Sanskrit word for 'truth') had been cited as an example of India's growing business sophistication and success. The company had even won numerous awards for innovation, governance and corporate accountability. In 2007, accountants Ernst & Young had named Satyam CEO Raju the 'Entrepreneur of the Year', and in 2008, MZ Consults cited Satyam as a leader in India in terms of corporate governance and accountability. Later in 2008, the World Council for Corporate Governance awarded Satyam the Global Peacock Award for global excellence in corporate accountability. Less than 5 months later, Satyam was revealed to have perpetrated a massive multi-year accounting fraud.

Satyam was found to have violated many fundamental rules of corporate governance, including not distinguishing the roles of board and management; failed separation of the roles of the CEO and chairman;

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weak appointments to the board; excessive directors' and executives' compensation; and inadequate protection of shareholder rights. In reaction to the revelations in 2009, legislation and regulations in India were enacted and adopted to, *inter alia*, alter procedures for the appointment of independent directors, enhance certain disclosures such as of pledged securities, require adoption of IFRS (although, as is the case in most frauds, the fault was not associated with which financial reporting standards were used, but rather in the proper adherence to *any* such standards), and the creation of a new corporate code by the Indian Ministry of Corporate Affairs.

In the author's experience, and consistent with the observation that 'hindsight is 20/20 vision', most frauds, once revealed, are indeed found to have been rather obvious, and should have been readily uncovered – if not actually prevented – by properly functioning mechanisms of corporate governance. For example, for many of the headline cases (Enron, WorldCom and Parmalat – all of which were personally studied by the author – and Satyam, Olympus and Toshiba, among many others), transactions and/or account balances that strained credulity should have been challenged by board members, which would surely have truncated the fraud and resulted in management changes.

For example, Satyam claimed to have cash balances of Rs. 3,983 crore (equivalent to over US$620 million) in bank accounts – certainly an odd circumstance. To be fair, Satyam also fabricated interest income purportedly flowing from these balances, and this would comfort those who might have otherwise have found holding such funds in non-interest-bearing accounts inexplicable (although the fictitious interest resulted in large and growing balances of receivables that could never be collected, which itself should have been a 'red flag'). In gross dereliction of duties, neither the board nor the auditors sought independent confirmation of the existence of these accounts.

Similarly, Parmalat (at $18 billion, the biggest financial reporting fraud to date) claimed huge sales of milk purportedly acquired in Singapore (a city-nation having few, if any, farms) and then sold to the state food agency in Cuba. Management assuaged the auditors' and board's curiosity by asserting that the (Communist) Cuban government would never respond to (capitalist nations') requests for confirmations of transactions or balances, and based on this theory the auditors simply skipped that normally mandatory audit procedure. In short, there was a total suspension of disbelief by board members (and auditors), which directly led to perpetration or continuation of these outrageous frauds, which would have been nipped in the bud had anyone with responsibility for oversight been alert to these glaringly obvious anomalies.

Board service, which in the past has been treated as a mere honorific, must be understood as being a serious and substantive engagement, constituting the first line of defence against corporate fraud. Only those willing to discharge the attendant obligations with emotional and intellectual energy need apply!

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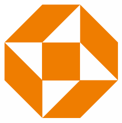


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