ISCA Pre-Budget Roundtable

PACE OF RESTRUCTURING

ISCA Pre-Budget Survey
Views from Business & Accounting Community

China Tax
Impact on Cross-border Services

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As I write this message, I believe businesses and households are already looking towards the FY2015 Singapore Budget Statement delivery on February 23, to find out what “goodies” are in store for them. For businesses, the wish list would likely centre on more government assistance to help them in their restructuring efforts. For households, additional resources dedicated to building Singapore’s social capital – such as enhanced support in the areas of eldercare and childcare, and any provision that reduces the cost of living – would be welcome.

As the national accountancy body, ISCA had taken the lead to seek the views of the business and accounting community regarding the Budget, and had submitted these insights to the government for its consideration. The Institute’s Pre-Budget Survey 2015, which measured the responses of 400 public and professional accountants, revealed that manpower issues and rental costs remain among the top concerns of businesses in Singapore. The respondents also voiced their hope for more targeted help to support them in their restructuring efforts and to give them a leg-up in their internationalisation plans. A similar topic was discussed at the ISCA Pre-Budget Roundtable, where panellists highlighted the need for differentiated policies and schemes to cater to companies of diverse sizes and profiles. These business and industry leaders also called for moves to address the severe shortage of Singaporean workers in certain sectors. Highlights of the ISCA Pre-Budget Survey and Roundtable are featured in this issue.

Increasingly, accounting professionals are confronted by a host of domestic and global challenges in their work. With Singapore being an open economy, anything that happens in the world will have an impact on us and the way we do business. Geopolitical issues, terrorist threats and most recently, the European Central Bank’s announcement of quantitative easing, coupled with the ongoing changes in the regulatory environment, and a competitive and complex business landscape, point to the critical need for members to be agile in order to stay ahead.

Being agile encompasses having the mindset – and the ability – to adapt to evolving circumstances, adopt innovative ideas and best practices, and adhere to new regulations when they come into effect.

In our profession, few business roles have changed as drastically as that of a CFO. Where traditionally, the CFO focused largely on the firm’s financial statements and capital structure, today’s CFO is expected to play a multi-faceted role spanning adviser, scorekeeper, operations manager, team leader and strategist – including roles that were once expected only of the CEO. And as economies move to battle money laundering, the CFO is also expected to oversee the setup and management of a strong anti-money laundering regime. How prepared are our CFOs to assume these wide-ranging responsibilities? Can they measure up to the new benchmarks and succeed? The articles, “The Changing Role of CFOs” and “Battling Money Laundering”, address these issues.

On the tax front, OECD’s Base Erosion and Profit Shifting project is a major initiative that we need to keep track of as it will require adaptation, adoption and adherence on our parts. While we await the final outcome, we can continue to strengthen our understanding of what constitutes tax planning as opposed to tax avoidance, and where necessary, advise our clients and apply the principles. We have articles on tax, audit and other topics relevant to your work within these pages.

For businesses to be sustainable, it is necessary for them to make changes to their usual way of doing things. Singapore firms undergoing restructuring are called to do so through upgrading and innovation. Some firms have emerged stronger while others are still floundering. In this respect, the accounting sector’s transformation has been more structured and steady as it had begun working towards its vision to be the global accounting hub for Asia Pacific some five years ago.

Today, the Institute continues to be committed to our members as we equip them with the skills, competencies and networks to navigate the complex business environment. We thank you for your support, and look forward to scaling greater heights with you.
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ACRA Announces Change in Effective Date for Legislative Amendments, Revised Fee Structure and Enhanced BizFile

ACRA is deferring the effective date of legislative changes to the Companies Act and the Business Names Registration Act to the second quarter of 2015. This will give all agencies and stakeholders concerned additional time to adjust and prepare for these legislative changes. The new simplified fee structure that ACRA had announced in October 2014 will likewise take effect in the second quarter of 2015. ACRA’s online business registration and filing portal, BizFile, which is currently being revamped, will be ready at the same time.

ACRA will announce the effective date and provide more details about two months before these changes are due to take place. To receive email updates, BizFile users can also subscribe to ACRA’s News Alert service at https://appiqs.acra.gov.sg/NewsAlert/logintosubscriber.aspx.
ISCA CPE Launches New E-Learning Courses on Ethics

There are now more ways for ISCA members to meet the mandatory Ethics CPE requirements. Riding the wave of technology and its prevalence, the Institute has launched two e-modules on Ethics. Titled “Ethical Dilemmas & Decision Making” and “Speaking Up, Raising Concerns & Whistleblowing”, these modules were developed and rolled out late last year by ISCA.

The web-based modules were designed to provide enhanced access and greater ease of use and navigation. ISCA members who are travelling can still complete the courses as they are available 24/7, via various platforms including the mobile phone, iPad and laptop/computer.

Former ISCA Council Member and Independent Director Lim Boon Cheng liked accessing the course on his sofa. He referred to the e-courses as being “marvellous”, and appreciated the “replay” button for repeats, and “pause” button for breaks “without missing any part of the lesson”. Although he faced initial hiccups with his “ancient iPad”, he eventually completed the course on his iPhone 5.

ISCA Corporate Governance Committee Member Chow Kam Wing, who is Executive Director and Chief Financial Officer of Micro-Mechanics (Holdings), commented, “My working schedule is tight and unpredictable, so attending classes would be difficult for me. This online course may be my solution. I can study at any time, in any place and at my own pace, without having to go to class at a fixed time.”

“PAIBs play an important role in the financial reporting supply chain, and they may encounter pressure to act unethically. These e-learning courses will help support them in fulfilling their responsibility to act in the public interest,” said Deputy IESBA Chairman and ISCA Ethics Committee Chairman Kwok Wui San. “Digital is now the preferred medium of communication. It also demonstrates how the tech-savvy world today will want to access and move with the times technologically. I hope that ISCA will continue to look at ways to utilise the immense technological possibilities in making ethics-related materials more accessible and flexi-friendly going forward.”
The last Mingles session for 2014 brought together 15 members for a very special gastronomic journey. Called “Dining in the Dark”, the experiential event on 17 December 2014 was facilitated by the Singapore Association of the Visually Handicapped (SAVH).

Our members experienced what it was like to be visually impaired without the use of blindfolds, which gave them an idea of the challenges that persons with visual impairment face in their daily lives. Through the dining experience, SAVH also showed how their visually-impaired clients can adapt and overcome the hurdles so that they can live and work independently, and contribute to society.

We would like to thank SAVH staff Joji Nana Sualan for coordinating the whole event, and Ruth Tan for supervising the kitchen team which prepared our set-course meals. Our special thanks also goes to Leong Chee Choy, a specially-trained SAVH client who served us during dinner. Their efforts made the event a most memorable and successful one for us.

Over 80 members attended the monthly ISCA Breakfast Talk on 9 December 2014, where Shariq Barmaky, Audit Partner, Deloitte & Touche, touched on “Financial Reporting Standards Updates - Overview of Standards Impacting 2014 and 2015”.

Many accounting professionals have had to re-examine the new requirements in FRS 110 Consolidated Financial Statements and FRS 111 Joint Arrangements that came into effect for annual periods beginning 1 January 2014. The new requirements under FRS 110, in particular, represented an overhaul of what they previously understood about “Control”. Mr Shariq shared on how to appreciate the new concepts underlying the elements of “Control”, and principles surrounding accounting for joint arrangements. He also covered other key standards that may impact members in 2014 and 2015, and numerous topics in relation to FRS.

Members found the hour-long session enriching and informative, and communicated their preference for a longer session. As such update sessions are exactly what many members were looking forward to in the year ahead, they called for ISCA to hold related supplementary sessions so they can benefit from more indepth analysis.
Limited spaces are available for each event and they are on a first-come-first-served basis. Dates and events are subject to change without prior notice.

For more details [http://corp.isca.org.sg/membership/events-calendar](http://corp.isca.org.sg/membership/events-calendar)

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An Adrenalin-pumping Close to ISCA Games 2014

They met on the court, in the field, and on the sand. Indoor and outdoor. They strategised, trained hard and participated in the games with all their heart and soul. After months of intense competition beginning in July, the ISCA Games finally came to an end.

On Saturday, 29 November 2014, more than 100 party-goers gathered at Clarke Quay’s most happening nightspot, The Pump Room, to mark the closure of another successful ISCA Games. ISCA members, including games participants, supporters and more, came together to network and mingle after all the “rivalry” as they had pitted their skills across 25 different sporting categories.

“Foes” became friends again as staff from Baker Tilly, Deloitte & Touche, EY, Foo Kon Tan Grant Thornton, KPMG, Mazars and PwC; ISCA’s Community, Social and Sports Advisory Panel and senior management, and more, relived the exhilarating moments of the competition, celebrating skills and sharing anecdotes. The bonds and friendship across companies forged through the Games encapsulated the ethos of the Games.

KPMG Asia Pacific Chairman and Singapore Managing Partner Tham Sai Choy (right) received the ISCA Games 2014 championship trophy from Mr Ee.

Team KPMG

A rousing toast: Cheers!

ISCA Games 2014 Closing Ceremony took place at the uber-cool The Pump Room.
Team KPMG won 14 of the 25 games in the competition, and defended the championship title.

Ultimate Frisbee, which became a full-fledged game instead of a novelty one, was enthusiastically received by many members. We hope to include more games which our members enjoy in our future Games.

KPMG successfully defended its championship title - the teams won 15 out of a total of 25 games, giving them a total of 60 points. Coming in second was PwC, followed very closely by Deloitte & Touche, and EY respectively. The Commerce Team also performed well, coming in strongly as the champion for Badminton. Foo Kon Tan Grant Thornton, Moore Stephens and Nexia TS earned their first points in Basketball (Men), Carrom and Volleyball respectively.

We would like to thank our members - participants and supporters - and the partners of their firms, for their fabulous support of the Games.

We look forward to more robust participation in this year’s Games.

PwC took the gold in Touch Rugby.

Team Deloitte showcased its share of trophies and medals.

CSS’s Mr Lim welcomed the party-goers and thanked them for another successful Games.
FOCUS
ISCA PRE-BUDGET ROUNDTABLE 2015

ISCA PRE-BUDGET ROUNDTABLE 2015
Pace of Restructuring

BY PERRINE OH

eld for the sixth consecutive year, the ISCA Pre-Budget Roundtable 2015 on January 13 served as an invaluable platform to gather the views and insights of business leaders with regard to past items in Budget 2014 and the upcoming Budget 2015. The Budget Statement for 2015 will be delivered by Deputy Prime Minister and Minister for Finance Tharman Shanmugaratnam in Parliament on February 23.

The Roundtable brought together top management and business leaders of trade bodies, accounting firms and

ISCA PRE-BUDGET ROUNDTABLE 2015 PANELLISTS

(Co-chair) GERARD EE
President
Institute of Singapore Chartered Accountants

(Co-chair) LIANG ENG HWA
Chairman
Government Parliamentary Committee (Finance and Trade & Industry)
C-suite executives to discuss and provide feedback on the Singapore Budget. The key insights raised at the Roundtable, together with ISCA’s Pre-Budget Survey findings, serve as important feedback to policymakers, regarding Singapore Budget matters, for their consideration in the formulation of the annual Budget.

As Singapore celebrates its golden jubilee (SG50) this year, it is an opportune time not only to reflect upon our past achievements but also to look forward to the future with confidence. Our past economic strategies have been successful in developing Singapore’s economy. Some conditions that allowed Singapore to succeed were an open and business-friendly location, sound infrastructure, a highly educated workforce, and a reputation for being a trusted business and financial hub.

Indeed, the strengths and advantages that Singapore has built up put the city-state in a strong position to remain competitive in the next five to 10 years. Beyond that, however, Singapore must develop new strengths and niches, and do things differently in order to maintain its competitiveness. Innovation, productivity and higher-level skill-sets will be key to Singapore’s future growth. Hence, there is a continued need to restructure the economy.

While economic restructuring may lead to painful situations for businesses and comes with significant risks, Singapore runs the
danger of seeing the economy stagnate if it does not restructure fast enough in the face of competition which is quickly eroding the advantages that we have built up over the years.

At the same time, a focus on building up social capital is also important in developing a productive workforce. Social support – in areas such as eldercare and childcare – provides assurance to individuals that their social and family needs are being met, allowing them to devote themselves more fully to their work.

Such support frees up individuals from some of the major pressures of daily life so that they can be more productive at their work places. In this respect, the “social” aspect should also be taken into consideration in restructuring our economy and raising productivity.

“Economic restructuring is a long-term endeavour. Fortunately, we are implementing our restructuring from a strong position and the government has the resources to further help businesses if need be.”
We must press on with restructuring but stay vigilant on the potential downside risks,” said Liang Eng Hwa, Chairman, Government Parliamentary Committee (Finance and Trade & Industry). Mr Liang was the Roundtable Co-chair with ISCA President Gerard Ee.

“How can we free up the individual from the pressures of family life and home so that, at whatever level, they can function to their optimal level at the workplace? I think that is what’s missing when we talk about social capital,” said Mr Ee.

The Roundtable discussion highlighted optimism in the opportunities arising from the upcoming ASEAN Economic Community (AEC), but also the transitional pain experienced from the ongoing economic restructuring.

**5 Key Areas raised at the ISCA Pre-Budget Roundtable 2015**

1. **Government Policies, Business Costs and Manpower**
   
   With regard to helping companies cope and adapt, panellists raised concerns about issues related to policy formulation and implementation. These include concerns that policies are not targeted enough to meet the needs of individual sectors or different firm sizes, that blunt policy instruments give the perception that policy-makers are detached from ground realities. Sunset clauses in schemes should be considered for removal. Schemes could be tweaked according to the needs of the life cycle of a business, for example startup, growth stage, etc. Further, schemes introduced to help small and medium-sized enterprises (SMEs) boost productivity may be confusing, or could be implemented with less cash flow and administrative challenges for the businesses. An SME-centric agency could better coordinate these schemes to meet SME needs and also to reach out to SMEs. Panellists said that the business sector welcomes secondment of policy-makers to businesses to enhance the effectiveness of policy formulation.

   Further, panellists affirmed that the top business concerns are costs-related, such as wage cost, foreign worker levy and rental – a result consistent with ISCA’s survey findings. Additionally, the quota on foreign workers should be sector-specific and should not be applied on jobs that Singaporeans view as being less desirable. Policy-makers should examine further the causes of rental inflation over the years, such as changes in market arrangements or structure in the property market, to understand how to better contain rental cost escalations.

2. **Productivity and Innovation**

   Panellists affirmed that 70% of the workforce and contribute to about half of our GDP. When we look at how we want to be future-ready, we need to look at how we can help SMEs to build capabilities with specific schemes.”

   **DR JANNIE CHAN** “You either have quotas or levies. If you take away the levies, at least we can then increase the wage of our local (workers). Some retailers are paying half a million dollars in levies even with quotas in place. With quotas and levies, it is a double restriction.”

3. **Mindsets and Attitudes**

4. **Social Capital**

5. **Internationalisation**

   **TAN HEE TECK** “Focusing on SMEs, I think it is important to understand their needs as they collectively employ

   **PROF SUM YEE LOONG** “We have progressed a lot over the past 50 years. There are jobs that Singaporeans do not
Panellists acknowledged that given rising business costs and a tight labour market in Singapore, businesses must raise productivity in order to grow. While a variety of productivity schemes are available, companies need to also know how to raise productivity and transform themselves holistically. It was discussed that technology remains an important enabler to drive productivity. The government could help to educate businesses to be savvy with technology while providing support with existing government schemes.

### PRODUCTIVITY AND INNOVATION

More ways should also be found to incentivise and encourage innovation among companies. Panellists highlighted the importance of motivating the Singapore-based multinational corporations (MNCs) and SMEs to own and develop key assets, such as intellectual property, in Singapore. Policies may perhaps be finetuned to steer business behaviour in the desired direction.

To further encourage productivity and innovation, greater collaboration between SMEs and universities would also be useful. Arrangements to support such developments can be put in place; this will be mutually beneficial as undergraduates can gain hands-on experience while SMEs can at the same time gain better access to this talent pool.

**Max Loh**: “Productivity incentive schemes are certainly good for their intent and purpose. However, schemes are only enablers of change. Ultimately, it’s about the mindset, knowhow, business processes and conviction – the entire ecosystem must rally us towards the productivity initiative. R&D and innovation are the main drivers of productivity. Companies know that, but want to do. My question is whether we need a quota (for these jobs)? It would be different if we are talking about PMEs. We should be looking at applying restrictions to these jobs.”
execution of these more difficult levers remains a challenge. The question we need to ask critically is: Do companies really know how best to drive innovation and improve productivity?”

**FRANKIE CHIA** “Several government incentives are on a reimbursement basis which creates a lot of administrative issues and delays for SMEs. On top of this, SMEs also need to worry about their cash flow. One suggestion is for government schemes to pay out directly to the vendors/consultants instead.”

**JEANN LOW** “The use of technology increases our productivity and makes use of resources that would otherwise be idle. Business models have evolved, with greater ability to share resources. That has been the success formula. We need to look at enabling companies either to correctly invest in or use technology to step up on productivity.”

**CHRIS WOO** “The role of intellectual property in today’s economy cannot be over-stated. This covers many value drivers and different aspects of the business, from technology to brands. To develop, own and exploit such key assets in and from Singapore is fundamental to future growth, for both Singapore-based MNCs as well as SMEs.”

**MINDSETS AND ATTITUDES**
Panellists also mentioned that employers have noticed a deterioration in the quality of the Singaporean workforce, with some noting that workers in Singapore have developed a misplaced sense of entitlement. One effect of this is that Singaporeans now tend to avoid jobs, particularly those in the service industry, which are deemed to be less desirable. It was discussed that efforts should be made to reinforce the idea that every job is a good job, and that every profession should be one that workers can be proud of. Perhaps schemes or incentives could be made available to support private or public organisations to undertake activities or educational efforts to change mindsets.

There is no doubt that the number one priority for Singapore’s economy and its businesses is to improve productivity. Small companies need help from large companies to understand how to go about improving productivity. A key component of achieving increased productivity is a much more engaged workforce.

**VICTOR MILLS** “Why are we always described as being “under happy” in surveys? How do we as a society begin to move the dial, improve workforce attitudes and reduce the thinking among parents, among job-seekers, that there is only a very narrow definition of what a good job is?”

**HO MENG KIT** “We have to move away from the paradigm where we are charging first-world prices for goods and services while having third-world input costs. If you pay workers first-world wages, attitudes will change and they will want to serve.”

**SOCIAL CAPITAL**
Several panellists focused on the importance of the social dimension in building an inclusive nation, where social capital can be created from the trust and cooperation that people cultivate through having more social support or networks. Social capital could be developed through providing incentives to raise the employment of seniors and other disadvantaged groups, reviewing
the allowance of certain relevant
tax deductions and enhancing child
reliefs, and fostering volunteerism.

Incentives could also be
considered to encourage the private
sector to increase their commitment
to being socially responsible through
supporting employee volunteerism,
which could positively influence
mindsets and attitudes. Volunteers
could benefit from skills gained
through volunteer activities, which
they could then apply in their
work places.

These will contribute to
increasing the level of social support
for the working population and other
vulnerable groups in Singapore. The
importance of social capital cannot
be overlooked even as other ongoing

Internationalisation

Besides encouraging
businesses to take advantage of
the establishment of the AEC, when going
overseas, the Singapore brand should
also be leveraged upon. There are
views that the government needs
to give incentives that recognise
and encourage brands to be built
internally by Singapore firms.

A pertinent challenge to going
overseas is finding trusted overseas
partners or suppliers. There
were also views that the external
environment is very uncertain, thus,
this may not be a good time to go
abroad. A different perspective of
internationalisation, according to the
panellists, was that it could benefit
from some finetuning; for example,
tax treaties could be refreshed with
the aim of maintaining Singapore’s
competitiveness as a business hub.

No one can afford to stand
still in today’s competitive globalised
economy. We must make sustained
efforts at promoting investment and
enterprise growth as well as finetune
our policies and initiatives to enhance
the value of Singapore as an economic
hub. For instance, Singapore was a first
mover in tax treaties, but our treaties
are now older and other countries have
since signed treaties that are more
relevant and progressive. It’s time
we review and refresh our existing
tax treaties, and negotiate new and
improved ones.”

“I have to inspire the new
generation of Singapore entrepreneurs
to build brands. There are currently no
significant incentives, especially
tax-wise, which assist or reward
businesses for building good brands
from scratch. Brands in themselves
are extremely important as businesses
venture abroad and seek to compete in
the international market.”

“Businesses are
interested to expand overseas,
especially given the establishment of
the Asian Economic Community. Firms
are looking for broad-based holistic
government support to penetrate larger
overseas markets. Businesses have
cited difficulty in finding trustworthy
partners or suppliers abroad as their
top concern with regard to overseas
expansion.”

Perrine Oh is Manager, Research, ISCA.
Recent forecasts by the International Monetary Fund (IMF) estimate that the global economy will grow by 3.8% in 2015. While this represents an improvement from the 3.3% growth forecasted for 2014, growth in 2015 is expected to be hampered by persistent weakness in the Eurozone and slowdowns in major emerging markets.¹

A quarterly poll of professional forecasters by the Monetary Authority of Singapore released in November 2014 estimated that Singapore’s GDP growth would reach 3.1% in 2015.²


Amid this prevailing economic outlook, the annual ISCA Pre-Budget Survey was conducted to gather the views of the CA (Singapore) community with regard to their business outlook and wish list for the Singapore Budget 2015. In particular, this year’s survey sought to gather feedback on the pace of economic restructuring and the focus areas that respondents think are important.

The survey was well received, attracting 400 participants from the accounting and business community. The findings enabled the Institute to provide pertinent insights and feedback to the government for Budget 2015. Further, the findings will be crucial in allowing ISCA to develop and refine relevant initiatives to meet the needs of our members.

**BUSINESS CONCERNS**

The results indicate that costs remain a key business concern for many respondents. In particular, business and hiring costs were ranked the top two out of a total of seven surveyed concerns. In contrast, external factors such as global demand and geopolitical concerns were rated as being of relatively less concern to respondents (Figure 1).

![Figure 1 Top business concerns](chart)

**Legend**
The figures in the chart represent the mean score of each category.
1. Not concerned at all
2. Slightly concerned
3. Moderately concerned
4. Very concerned
5. Extremely concerned

Respondents were asked to rate from 1 (Not concerned at all) to 5 (Extremely concerned).
Figure 2: Usefulness of schemes for productivity

Compared to the 2014 survey, respondents’ ratings of the usefulness of schemes in raising productivity have generally improved in 2015. The Productivity and Innovation Credit (PIC), PIC Bonus, Wage Credit Scheme (WCS), and PIC+ for qualifying SMEs were schemes that were rated as being relatively more useful in helping firms raise productivity. On the other hand, respondents perceived schemes such as iSPRINT, Micro Loan Programme (MLP) and WorkPro to be relatively less useful (Figure 2).

Further, the majority of respondents also expressed the desire to see most of these schemes remain in place for between three and 10 years in order for them to be effective in helping businesses to raise productivity.

The survey also provided insights into how the various qualifying activities of the PIC scheme are being used. The results show that businesses continue to make insufficient use of the PIC scheme on activities such as design, intellectual property and innovation (for example, Research and Development), that may substantially increase business value (Figure 3).
This is in contrast to activities such as staff training and acquisition of equipment, for which the PIC scheme is more frequently utilised at most respondents’ organisations.

Business transformation and higher value creation will be achieved in the long run if businesses focus on finding more ways to use PIC for innovation-related activities. The findings also show that 25% of respondents who utilise PIC for the acquisition or leasing of equipment stated that they strongly agree that PIC is useful for this activity.

**INNOVATION, VALUE-ADDED ACTIVITIES, AND RESTRUCTURING**

Respondents rated business strategy development as the top area which would help their organisations become more competitive and add value. However, continuing the trend observed in the 2014 survey, areas such as business innovation & design, and intellectual property & franchising, were rated by respondents as being relatively less important to helping organisations become more competitive (Figure 4).
The majority of respondents (60%) found the pace of restructuring acceptable. At the same time, 26% of respondents found the pace too slow while 15% felt that restructuring was progressing too quickly. The results also indicate that various restructuring challenges – including staff and management’s inability to change and adapt, and not having internal capability to reorganise – remain (Figures 5).

**INTERNATIONALISATION**
Respondents rated double-tax deductions for internationalisation and the market readiness assistance grant as the two relatively more effective schemes for supporting businesses in venturing overseas. For businesses looking to take advantage of opportunities offered by the upcoming creation of the ASEAN Economic Community, support in establishing overseas networks was rated as being the most useful.

**BUDGET WISH LIST**
Respondents appear to echo the
sentiments of respondents in the last survey, in terms of the types of support that they want from Budget 2015. In particular, cost and manpower concerns continue to occupy their thoughts. Support to reduce rental costs and easing of manpower regulations ranked as the top two items in the Budget wish list.

In contrast, support for growth activities or those with potential to increase value-add of a business – such as support for venturing overseas and support for branding activities – ranked relatively lower (Figure 6).

The top three desired benefits in the respondents’ wish list to help households are (1) Tax savings/rebates, (2) Healthcare benefits, and (3) Housing rebates/grants (Figure 7). Respondents who cited tax savings/rebates as being relatively more important believe that such rebates/schemes will benefit everyone, rather than a specific group in Singapore. They also feel that tax savings could help increase household disposable income.

**BUDGET RECOMMENDATIONS**

Based on the survey findings, items for consideration in Budget 2015 are:

- Offer more support for businesses to strengthen talent, and improve capabilities for business restructuring and business strategy development and execution to enhance competitiveness;
- Offer support to businesses in areas deemed to be of greater concern, such as rental, hiring and training costs, while finding new ways to incentivise businesses to focus more on innovation or other higher value-added activities;
- Consider extending the duration of government schemes; respondents have expressed the desire for schemes to remain in place for longer time periods in order for businesses to effectively use them to raise productivity;
- Review schemes that are deemed to be relatively less useful, such as iSPRINT, MLP and WorkPro;
- Enhance measures to help companies venture overseas, particularly in the areas of tax knowledge and overseas network establishment;
- Continue to provide support to households in areas deemed to be contributing to the high cost of living (for example, healthcare and housing).

This year, ISCA organised the annual Pre-Budget Roundtable on January 13. A distinguished panel of business leaders gathered to discuss a range of issues pertaining to the Budget. These discussions, together with the findings from the Pre-Budget Survey, provided valuable insights and feedback with regard to Budget matters.

As the national accountancy body, the Institute will work closely with businesses and stakeholders, particularly our members, to help them in their efforts to raise productivity and stay competitive. ISCA

![Figure 7 Household: Budget wish list](image)

<table>
<thead>
<tr>
<th>Benefit Category</th>
<th>Overall</th>
<th>PAIB</th>
<th>PA</th>
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<tbody>
<tr>
<td>Tax savings/rebates</td>
<td>28%</td>
<td>26%</td>
<td>28%</td>
</tr>
<tr>
<td>Healthcare benefits</td>
<td>24%</td>
<td>24%</td>
<td>24%</td>
</tr>
<tr>
<td>Housing rebates/grants</td>
<td>16%</td>
<td>15%</td>
<td>20%</td>
</tr>
<tr>
<td>Childcare benefits</td>
<td>6%</td>
<td>15%</td>
<td>18%</td>
</tr>
<tr>
<td>Elderly care benefits</td>
<td>11%</td>
<td>11%</td>
<td>10%</td>
</tr>
<tr>
<td>Enhancing the reliability and capacity of public transport</td>
<td>7%</td>
<td>4%</td>
<td>14%</td>
</tr>
</tbody>
</table>

Note: Percentages may not add to 100% due to rounding


Clarence Goh is Manager, Research, ISCA.
here are few business roles in an organisation that have been transformed as extensively as that of the Chief Financial Officer (CFO). Today, the conventional model of the CFO as chief accountant or bookkeeper primarily focused on the firm’s financial statements and capital structure is outdated and irrelevant.

The modern CFO is expected to be an adviser, scorekeeper, operations manager, team leader and strategist. They have to juggle donning these hats while ensuring their organisation’s survival and expansion, and face internal, public and regulatory scrutiny that was once expected only of Chief Executive Officers (CEOs).

KPMG’s latest Global CFO Research report, “Being the best: Inside the intelligent finance function”, shows that the journey of a finance function to becoming “best in class” in terms of operational efficiency, business support effectiveness and the ability to add real value to their organisations is often complicated by many challenges. Externally, it includes the challenges of rapid globalisation, increasing competition, new rules and regulations, disruptive technologies and the continuing fall-out from the last global financial crisis.

As if the external environment did not provide enough of a challenge, internally, there are pressures from a shortage of skilled finance staff, increasing organisational complexity, outdated IT systems and budget constraints.

**FORBES CEO SURVEY**
A recent Asia-Pacific-wide survey jointly conducted by KPMG and Forbes Insights surveyed 178 CEOs, business owners and company chairmen from large Asia-Pacific-based companies

---


on the performance of the finance function and the changing role of its leader, the CFO.

Interestingly, 72% of CEOs from high-performing companies believe that the role of the CFO will increase in importance over the next three years as compared to other C-suite roles.

On the other hand, almost one-third of the polled CEOs said they were unhappy with the performance of their CFO and a whopping 80% think that their CFOs could and should do a better job of managing their teams.

So it seems there is a growing expectation gap between CEOs and their finance chiefs, many of whom they regard as “lost in the numbers, mired in regulatory minutiae, distracted by the daily demands of different compliance, tax and financial requirements”. This suggests a growing need for CFOs to rethink their priorities and underlying motivations and skills.

**A NEED FOR STRATEGIC PARTNERSHIP**

KPMG’s 2014 survey report concludes that CFOs need to drastically redefine their traditional finance operating models, the objective being to deliver faster, more accurate reporting and insightful analysis while at the same time safeguarding compliance, managing risk and reducing cost. This is indeed a delicate balancing act that requires the CFO to be a trusted business partner rather than just a diligent scorekeeper.

To be able to achieve this transition, the age-old finance pyramid model, where much time and attention is devoted to the “basics” such as financial operations (50%) and financial reporting and control (30%) – and less to financial performance (20%) – needs to be turned on its head.

Today’s leading practices tell us that these key finance activity ratios should be inverted, in a 20:30:50 ratio respectively, so that more strategic, value-adding finance activities can be undertaken and the less value-adding finance activities can be standardised, automated and even outsourced.
At the same time, the finance pyramid should also become smaller in terms of the overall number of finance resources that are required to run the finance function, so the finance team can devote more energy and time to support activities for the business, enabled by more sophisticated Enterprise Performance Management (EPM) tools and enhanced data analytics.

**FINANCE TARGET OPERATING MODEL**

So what does a world-class finance function look like, and what does a transformation into an “intelligent finance function” entail in practical terms?

The transformation journey starts with the creation of a comprehensive Target Operating Model (TOM) for the finance function, underpinned by a clearly-defined finance vision that is aligned with the overall business strategy. It needs to take into account the existing organisational culture, finance processes and systems limitations. Six areas need to be considered to create a fit-for-purpose Finance TOM:

- **Services** How the services (such as financial reports) that the finance function offers need to shift from being internally focused to becoming a value driver for the organisation;
- **Organisation** How to govern the finance function and how the different departments within a finance function need to be integrated, moving away from operating in silos;
- **People** Finance teams need to become business partners rather than scorekeepers, which requires upgrading of skills and embracing of cultural change;
- **Processes** Where possible, these should be standardised and optimised as opposed to being customised for different business units;
- **Technology** Implementing a central data repository model with integrated finance systems, and dealing with incompatible systems and legacy data models;
A successful finance transformation calls for the CFO to become a steward of change. This will see CFOs assuming leadership roles as agents of change through the adoption of best practice, as gatekeepers who enforce governance and risk management, and as drivers of growth who help deliver value to the business.

**Location**
Looking beyond merely decentralised processing of information towards strategic sourcing for finance operations through finance shared services and outsourcing.

**AN INTELLIGENT FINANCE FUNCTION**
Depending on the maturity of the current finance function and how far along it is to becoming an intelligent finance function, our research and experience suggest that these are the most important steps going forward, once the Finance TOM has been established:

1. **Establish clear objectives and road map** A well-defined Finance TOM not only defines the future state of the finance function but also offers a clear road map on how to get there;

2. **Engage broadly with partners across the business** It is important to communicate with stakeholders across the company to align finance’s strategic goals with those of the business;

3. **Set realistic goals and timelines** Ensure that the transformation is done in manageable steps, with clearly-defined work-streams and reasonable timeframes that allow for flexibility;

4. **Lead with a clear “tone from the top”** with a strong commitment from the CEO and CFO and, if necessary, the whole board and all executives in charge of other business units that stand to benefit from the transformation;

5. **Develop a transparent governance framework** with clear roles and responsibilities and manage expectations judiciously;

6. **Build and manage the project’s “brand”** Develop tailored change-management communications highlighting incremental progress made, and sharing early successes;

7. **Manage talent during the transition**
Finance teams need to have the right number of finance professionals and the right mix of skills and experience at every step of the transformation journey.

A successful finance transformation calls for the CFO to become a steward of change. This will see CFOs assuming leadership roles as agents of change through the adoption of best practice, as gatekeepers who enforce governance and risk management, and as drivers of growth who help deliver value to the business.

Understanding and executing this transformation journey well will enable the CFO to support business growth, stimulate expansion and diversification, and resolve unforeseen concerns before they become real issues.

Martyn van Wensveen is Partner, KPMG in Singapore and Global Leader for Financial Management.
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For the past 10 years, Mr Tan’s company has been the dream customer of every property agent. His company buys and sells properties worth millions of dollars in Singapore and overseas. But the joy of the property agents soon turned to dismay when Mr Tan was convicted of money-laundering offences through the sale and purchase of his company’s properties.

A money launderer does not identify himself. He could be the person standing next to you on the MRT, or queuing up in front of you to buy coffee. But through profiling, or customer due diligence, you may just be able to spot the occasional bad apple in a portfolio of customers.

The essence of profiling is that you need to know who you are dealing with – in other words, who your customers really are. Not only do you need to verify your customer’s identity, more importantly, you need to identify who ultimately “controls” your customer. Information about the customer, such as business and risk profiles, where the monies come from, and patterns of transactions also enable you to form expectations of how your customer may behave, which will help to detect suspicious activities in a business relationship.

Profiling may sound like a lot of work, and it may only be in the initial stages, when you are doing it for the first time, such as for a new customer. Understandably, at the start, you may know nothing or very little about your potential customers, but over the years, you progressively find out more about them. The time invested in having a proper process to profile your customers may well be the saving grace for potential legal woes in the future.

**HOW DEEP SHOULD YOU DIG?**

There are varying intensities of background checks on customers. For example, if a well-known public figure or company knocks on your door, it is not necessary to do extensive checks as there would likely be a lot of information in the public domain. The frequency of
The essence of profiling is that you need to know who you are dealing with – in other words, who your customers really are. Not only do you need to verify your customer’s identity, more importantly, you need to identify who ultimately “controls” your customer.

ongoing monitoring can also be reduced if the customer is subject to regulatory disclosure requirements, such as the case for listed companies, or when reliable information on the customer is publicly available.

Without strong anti-money laundering systems and controls, which encompass customer profiling, criminals may exploit unsuspecting firms and professionals to facilitate their money-laundering activities.

When that happens, ignorance is not bliss. Under Singapore’s anti-money laundering laws, a person can be held liable if evidence shows that based on the circumstances, he ought to have suspected that money-laundering is occurring or has occurred.

A good defence would be to demonstrate that robust customer profiling has been performed and other sound anti-money laundering systems and controls are in place. For those in search of a guiding light to strengthen their anti-money laundering armour, the new Ethics Pronouncement (EP) 200 Anti-Money Laundering and Countering the Financing of Terrorism – Requirements and Guidelines for Professional Accountants in Singapore, developed by ISCA is one such beacon. Benchmarked to international recommendations, EP 200 will help to mitigate such anti-money laundering risks. For example, when checking the background of a corporate customer, you need to verify its name, whether it is a company, partnership or another legal form, and whether it still exists as a legal entity. The Accounting and Corporate Regulatory Authority has also adopted EP 200 for public accountants and accounting entities to follow.

Getting to know your customer may appear cumbersome but it is the shield you need to keep you safe from money launderers. So the next time you see your long-time customer Mr Tan and think you know him well, think again. He may not be the Mr Tan you know.

Kang Wai Geat is Deputy Head, and Fua Qiu Lin is Manager, Technical Standards Development & Advisory, ISCA. An edited version of this article was first published in The Business Times, 16 December 2014.
Since China’s new leadership came onboard in 2012, many reforms have been implemented to transform its economy. Over the years, Value-Added Tax (VAT) changes, mergers and acquisitions, and funds repatriation continue to be top issues many corporations have had to grapple with, in addition to the usual foreign exchange matters in any cross-border investments.

**VAT CHANGES AS CHINA TRANSFORMS**

China currently administers two sets of Indirect Tax systems. Broadly, services are taxed based on Business Tax (BT) and the VAT is applied on goods. If a service provider (who pays BT) buys goods, the service provider will have to incur VAT which it cannot claim tax credit on as it is a BT payer.

For greater efficiencies and to mirror international standards, progressive steps are already in place to transform the current two-system tax regime into one system by 2016. Some services such as transportation, telecommunications, cultural and creative services, logistics and ancillary services are already taxed via the VAT pilot scheme.

A company with RMB5 million sales turnover has an obligation to register the business as a VAT general taxpayer. This in turn allows the company to enjoy the tax credits where applicable. Smaller businesses can also enjoy these benefits if they choose to register as temporary VAT taxpayers and be subjected to supervision from the tax authorities.

Alternatively, small companies may pay VAT based on 3% of turnover. These companies will however not be able to enjoy the tax credits mechanism applicable for general VAT taxpayers. This was just one of many intricacies of the China tax regime that was explained by Kenny Chiu, Senior Manager, China Tax Desk, KPMG in Singapore, at a Tax Excellence Decoded session by the Singapore Institute of Accredited Tax Professionals.

In China, other than taking the tax credits available into consideration for general VAT taxpayers when they switch from being a BT taxpayer to a VAT-registered entity, it should be noted also that BT returns are filed with the Local Tax Bureau but VAT returns are filed with the State Tax Bureau.

Besides this, tax rates differ. China’s BT is mainly 3% and 5% depending on various circumstances while VAT rates vary according to the type of services and even the size of the businesses. For example, small businesses may choose to pay 3% VAT based on turnover, and while transportation companies charge 11% VAT, a 6% VAT applies for companies offering logistics services. In addition, BT affects the
Over the years, Value-Added Tax (VAT) changes, mergers and acquisitions, and funds repatriation continue to be top issues many corporations have had to grapple with, in addition to the usual foreign exchange matters in any cross-border investments.

**MNC IMPLICATIONS**

One significant impact is the tax treatment on cross-border services. In the past, businesses paying BT pay 5% on most services which were either exported from or imported into China. Currently, VAT-registered companies whose services are exported may be taxable, zero-rated or exempted altogether and imports subjected to value-added withholding tax though the China taxpayer recipient may claim an input VAT credit. For example, a Singapore company which charges management fees to its China subsidiary which is VAT-registered, will have a portion of the fees withheld as a tax credit.

The VAT regime will continue to expand across other sectors. The lifestyle services, including the hospitality sector, will be subjected to VAT and this will cover the Food and Beverage sector too. Companies currently paying 5% BT will need to be VAT-registered and change its tax administration. The VAT reform will continue to be expanded to the real estate and construction sector and thereafter, the financial services and insurance sectors.

**TAX ON INDIRECT TRANSFERS**

Another major issue that many companies grapple with when investing in China is the indirect transfer of China enterprises. In December 2009, China issued Circular 698 which, subject to some conditions, requires foreign entities to disclose the indirect sale of China enterprises – that is, when a holding company that owns a China enterprise is sold. Notice of such transfers must be given to the China tax authorities within 30 days of the agreement being signed. If the China
tax authority considers the holding structure of the investment not to have reasonable commercial purpose, they will categorise the transaction as one that is subject to a 10% withholding tax.

If the holding company has various offices across China, it may choose any one location to file this report to determine whether the transaction would be taxed or not. If the transaction is taxable, the holding company will then submit tax returns to the respective cities’ tax office.

In July 2014, another circular on tax administration of equity transfer was issued. One of the key pointers was that the China authorities will be leveraging on technology and other secondary sources to gather information on equity transfers, in addition to information from the taxpayer. This was illustrated in an announcement by the authorities in August 2014, where the authorities collected information on an offshore indirect transfer by a listed company from the Internet.

Another area where the China authorities will be making changes would be to formalise a structure that ensures a consistent application of tax treatment across various circumstances of equity transfers. A third aspect of the circular was a clarification on the key transactions the authorities will be taking note of when applying the regulations stipulated in Circular 698.

A detail to highlight in the July 2014 circular is the consideration on pricing. Instead of simply using net asset value, the market approach or the discounted cash flow method will be used for valuation purposes. It is advisable to supplement decisions with further analysis such as transfer pricing reports.

**TAX ON PROFIT REPATRIATION**

Singapore companies seeking to repatriate the profits from China will need to prove it is a tax resident of Singapore by providing a certificate of residence as an example. Another criterion is that the Singapore entity must be the beneficial owner of the income; this means the Singapore entity has control of the income received.

... small companies may pay VAT based on 3% of turnover. These companies will however not be able to enjoy the tax credits mechanism applicable for general VAT taxpayers. This was just one of many intricacies of the China tax regime ...
In a little red dot, as Singapore is sometimes referred to, many local businesses spearhead growth through overseas ventures or various offshore activities to achieve greater heights.

The conventional view arising from the judicial decision in *IRC v Duke of Westminster* (1936) that “every man is entitled, if he can, to order his affairs so that the tax attaching under the appropriate Act is less than it otherwise would be” trickled the flourishing of tax planning.

The internationalisation of business activities has, in more recent years, created a new environment where opportunities may be exploited and tax avoidance schemes creatively planned and executed.

**CONCEPTUAL DIFFERENCE BETWEEN TAX PLANNING AND TAX AVOIDANCE**

While tax planning and tax avoidance fall into the two different sides of the law, a fine line separates the two. A perennial debate between taxpayers and tax authorities around the world is where to draw this line.

**Tax planning**

Tax planning connotes the idea that every person is entitled to arrange his affairs in such a way as to attract the least tax liability. For this, the taxpayer avails himself of the tax concessions, exemptions or privileges under the law.

Should the taxpayer conduct his tax planning based on what is permissible without recourse to artificiality, he should not be denied the right to arrange his own affairs. Tax authorities would generally accept legitimate tax planning rendered by tax professionals in the right spirit of professionalism.

As businesses internationalise, they are increasingly exposed to the tax risks of the jurisdictions that they operate in. Different countries have tax laws embodying different tax concepts. The interaction of these tax laws often leads to double taxation for the taxpayer, where both the country of residence and the country of source would attempt to levy tax on the same income. Careful tax planning is required to help businesses avoid, or reduce the impact of, the tax traps resulting from the interaction of the tax laws.

**Tax avoidance**

Unlike tax planning, tax avoidance often involves the creation of artificial steps to alter an arrangement without genuine business or commercial reasons. Michael Edwardes-Ker, author of *The International Tax Strategy*, defines tax avoidance as the structuring of a transaction so that its profits legally avoid tax.

When a taxpayer has apparently circumvented the law by using an arrangement, often of a complex
nature, the main or sole purpose of which is to defer, reduce or completely avoid tax liabilities under the law, his actions would likely exceed what is allowed for tax planning and instead constitute tax avoidance.

Based on the case of McDowell & Co Ltd v CTO (1985), the Supreme Court of India concerned itself not merely with the genuineness of a transaction but also with its intended effect on fiscal principles. The Court also emphasised that artificial devices cannot be a legitimate aspect of tax planning.

Tax avoidance often involves a scheme which sole or dominant purpose is to obtain a tax benefit.

Other considerations to determine if there is tax avoidance include:
(a) Apart from tax considerations, does the transaction/arrangement make good investment or business sense? - in other words, would the taxpayer carry out the same transaction if there were no tax benefits?
(b) Does the transaction have any commercial substance, or is it purely form?
(c) Is the overwhelming motivation to undertake the transaction tax driven?
(d) What are the legal rights and obligations of the parties?
(e) Is the buyer in effectual and constant control of the seller?

In helping to decide whether a transaction constitutes tax planning or tax avoidance, one could examine the nature of the trade. Lord Denning put it very succinctly in Griffiths v J.P. Harrison (Watford) (1963) - “If the transaction is, in truth, a transaction in the nature of trade, it does not cease to be so simply because the trader had in mind a tax advantage. But if it is, in truth, a tax-recovery device and nothing else, then it remains a tax-recovery device notwithstanding

1 Legal maxim which means “what is expressed makes what is implied silent”, that is, when a matter is clearly provided in a document, the clear and precise meaning is to be adopted. http://definitions.uslegal.com/
that it is clothed in the trappings of a trade.”

ANTI-AVOIDANCE RULES
As governments around the world modernise their country’s anti-avoidance rules, the question arises as to how much reliance can be placed on cases decided under old legislations in interpreting such new anti-avoidance rules. Based on John v FC of T 89 ATC 4101 (1988–1989), the Australia court held that in accordance with the maxim expressum facit cessare tacitum, the fiscal nullity principle cannot be applied where there are already specific statutory provisions on a topic, such that there is no room for implication of any further matter on that same topic.

In Singapore, Section 33 of the Income Tax Act is the general anti-avoidance provision. This section provides that where the Comptroller is satisfied that the purpose or effect of any arrangement is directly or indirectly (a) to alter the incidence of any tax payable; (b) to relieve any person from liability to pay tax, or (c) to reduce or avoid any liability imposed, he may, without prejudice to such validity in any other respect or for any other purpose, disregard or vary the arrangement and make such adjustments as he considers appropriate, including the computation or recomputation of gains or profits, or the imposition of liability to tax.

The word “purpose” means “object” or “end in view”; it does not mean “motive”, so it is irrelevant whether the offending steps have a commercial motive or not. The purpose must be what it is intended to achieve, and this may be ascertained from the terms or inferences. The purpose of an arrangement can be seen from its effects or end results.

The word “effect” means the end accomplished or achieved.

What constitutes “bona fide commercial reasons” is a pure question of fact. Even if the taxpayer is able to clear this hurdle, he has also to show that one of the main purposes of the arrangement is not the avoidance of tax.

To successfully oppose the operation of the section, the taxpayer will have to prove that on the proper inference which could be drawn from an objective assessment of the terms of the arrangement and the manner in which it was carried out, the tax reduction effect is not a purpose of the arrangement but merely a necessary consequence of the arrangement.

OECD ACTION PLANS ON BEPS
As the world economy moves from the traditional business model to a more technology-based business model, the Organisation for Economic Co-operation and Development (OECD) has initiated efforts to tackle problems relating to Base Erosion and Profit Shifting (BEPS), whereby businesses exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations where there is little or no economic activity, resulting in little or no overall corporate tax being paid. As OECD updates its action plans for BEPS, taxpayers and tax authorities alike should ready themselves for the changes and challenges ahead.

CONCLUSION
Taxpayers should avoid overly-aggressive tax planning with no real commercial or business reasons as this is likely to be perceived by tax authorities as tax avoidance. With the changing tax landscape and the recent action plans on BEPS, taxpayers and tax authorities should be prepared for the changes and challenges coming their way.

ISCA
Accredited Tax Advisor (Income Tax)
Yee Fook Hong is Tax Partner, Ng, Lee & Associates-DFK, and Board Member of the Singapore Institute of Accredited Tax Professionals.
CONVERTIBLE BOND’S CONVERSION OPTIONS

Equity or Liability?

Sean continued, “I think the conversion option should be liability classified since it’s a fixed-for-floating arrangement. The conversion proportion formula clearly states that the “fixed” principal owed is to be converted into a variable or “floating” number of ordinary shares (Figure 1, Scenario 2).”

“I see. Well, some accountants may see the presence of a fixed-for-floating conversion term as apodictic proof that the conversion option is in substance a liability. Conversely, the presence of a fixed-for-fixed conversion term indicates that a conversion option should be classified as equity. However, I am not convinced such shorthand is sufficiently robust in its analysis. Let me explain why,” I said.

The voice on the other line sounded weary. “The two valuation specialists I spoke with couldn’t agree if the convertible bond’s (CB) conversion option is to be classified as equity or liability. I need this sorted out ahead of the IPO because there would be an impact on the profit and loss statement if it were classified as a liability. Can you help me?” Sean asked.

Figure 1 Convertible Bond Salient Terms

<table>
<thead>
<tr>
<th>Extract of Convertible Bond Salient Terms</th>
</tr>
</thead>
<tbody>
<tr>
<td>Principal</td>
</tr>
<tr>
<td>S$10 mil</td>
</tr>
<tr>
<td>Coupon</td>
</tr>
<tr>
<td>Zero</td>
</tr>
<tr>
<td>Maturity</td>
</tr>
<tr>
<td>Five years from the date of the subscription agreement</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Holder Conversion Option</th>
</tr>
</thead>
<tbody>
<tr>
<td>Conversion Period</td>
</tr>
<tr>
<td>Any time prior to maturity</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Conversion Proportion As a percentage of total shareholdings, calculated as:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Scenario</td>
</tr>
<tr>
<td>Reference Net Profit (RNP)</td>
</tr>
</tbody>
</table>

The conversion proportion is as follows:

<table>
<thead>
<tr>
<th>Conversion Proportion (%)</th>
<th>Principal / S$10 mil</th>
<th>Principal / 5 x RNP</th>
</tr>
</thead>
</table>

Settlement: By delivery of newly-issued ordinary shares

Source: BTC Analysis
A financial instrument that comprises straight debt and a conversion option that is classified as equity is recognised as a compound instrument, that is, it is a liability with an equity component. Conversely, if the conversion option is classified as a liability, the financial instrument is recognised as a hybrid instrument, that is, a host contract with an embedded derivative.

RECOGNITION CRITERIA
The idea that a fixed-for-floating CB’s conversion ratio results in a debt classification while a fixed-for-fixed conversion ratio results in an equity classification can be traced back to Financial Reporting Standards (FRS) 32, paragraph IN6-IN7 (Figure 2).

IN6
In summary, when an issuer determines whether a financial instrument is a financial liability or an equity instrument, the instrument is an equity instrument if, and only if, both conditions (a) and (b) are met.

a) The instrument includes no contractual obligation:
   i. to deliver cash or another financial asset to another entity, or
   ii. to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the issuer.

b) If the instrument will or may be settled in the issuer’s own equity instruments, it is:
   i. a non-derivative that includes no contractual obligation for the issuer to deliver a variable number of its own equity instruments, or
   ii. a derivative that will be settled by the issuer exchanging a fixed amount of cash or another financial asset for a fixed number of its own equity instruments. For this purpose, the issuer’s own equity instruments do not include instruments that are themselves contracts for the future receipt or delivery of the issuer’s own equity instruments.

IN7
In addition, when an issuer has an obligation to purchase its own shares for cash or another financial asset, there is a liability for the amount that the issuer is obliged to pay.

However, FRS 32.IN6(b) has been explicit to associate fixed-for-floating and fixed-for-floating conversion terms with a non-derivative and a derivative respectively. As such, a valuer may wish to consider both (1) the conversion terms and (2) the substance of equity instruments used in settlement options (derivative/non-derivative) in order to classify a conversion option accurately.

Derivative vs Non-derivative
For example, a financial obligation that can be settled by offering a non-derivative in the form of either cash or shares would likely be respectively liability or equity classified, ceteris paribus. At this juncture, I would like us to take a moment to think about the significance of a bondholder wanting to receive shares, regardless of whether it is for a fixed or variable number. What was his original intention for entering this transaction? Was it to provide debt or equity capital?
embedded derivative. As financial instrument terms vary widely in scope and complexity, the above guidelines are not exhaustive and I advise parties to seek professional advice tailored to your specific circumstances.

SUMMARY

Accountants have commonly relied on the fixed-for-fixed vs fixed-for-floating conversion ratio feature to conclude if a conversion option is to be equity or liability classified. We are of the view that this approach is insufficiently apodictic.

A conversion option that is wrongly classified as a liability may lead to greater earnings volatility as fair value changes arising on subsequent re-measurement are recognised on the profit and loss statement.

Instead, I recommend that we first discuss the commercial intentions of the parties involved in the transaction. I am of the view that this approach is insufficiently apodictic.

The above thinking points are intended as a starting point to facilitate discussion and to help us understand if the conversion option is likely to give rise to a contractual obligation when granted.

A financial instrument that comprises straight debt and a conversion option that is classified as equity is recognised as a compound instrument, that is, it is a liability with an equity component. Conversely, if the conversion option is classified as a liability, the financial instrument is recognised as a hybrid instrument, that is, a host contract with an embedded derivative.

Figure 3 Financial Instrument Recognition (Conversion Options)

For an instrument settled in the issuer’s own equity instruments, is there:

- Any contractual obligation to deliver a variable number of issuer’s own equity instruments?
- Can the derivative be settled ONLY by exchanging fixed amount of cash for a fixed number of issuer’s own equity instruments?

<table>
<thead>
<tr>
<th>Non-derivative</th>
<th>Derivative</th>
</tr>
</thead>
<tbody>
<tr>
<td>NO</td>
<td>YES</td>
</tr>
</tbody>
</table>

I am of the view that FRS 32.IN6(b)(i)’s “non-derivative” clause means to prescribe that even if the bondholder received a variable number of shares, there is the possibility that his commercial intention is to own a portion of the equity in the business.

However, if the shares offered are a derivative, we would be interested to understand if the settlement instrument was derived from a cash equivalent obligation. For example, a bond issuer with a cash obligation may have the option to settle that obligation using a variable number of shares. In this case, the shares represent a form of settlement derived from what is in substance a cash equivalent obligation. As the variable number of shares offered represents a cash equivalent obligation, the conversion option would be classified as a liability.

FRS 32.IN6(b)(ii) also states the reverse to be true, that is, a settlement option where a fixed number of shares offered multiplied by a future share price, that is, on exercise, is not likely to represent a cash equivalent obligation, the conversion option would be classified as equity.

In view of the above, we would typically consider, inter alia, the following to assist in classifying a conversion option:

- Does the conversion option have a finite tenure?
- Is there any contractual obligation to deliver cash or cash equivalent obligation?
- If settlement is in the form of shares, are the shares a derivative of a cash equivalent obligation?
- Does the conversion option allow for a conversion of a fixed amount of principal into either a fixed or variable number of shares?
- Does the issuer have the unconditional right to avoid delivering cash or another financial asset?

The above thinking points are intended as a starting point to facilitate discussion and to help us understand if the conversion option is likely to give rise to a contractual obligation when granted.

A financial instrument that comprises straight debt and a conversion option that is classified as equity is recognised as a compound instrument, that is, it is a liability with an equity component. Conversely, if the conversion option is classified as a liability, the financial instrument is recognised as a hybrid instrument, that is, a host contract with an embedded derivative.

As financial instrument terms vary widely in scope and complexity, the above guidelines are not exhaustive and I advise parties to seek professional advice tailored to your specific circumstances.
CONFOUNDING ISSUES

Audit market reformers appear to think so, promulgating policy that limits the types of NAS that can be provided by a company’s incumbent auditor. The United States (US) Sarbanes-Oxley Act (SOX) section 201 lists nine NAS that may impair auditor’s independence and hence, are prohibited; the European Union (EU) market reform specified the types of NAS that are prohibited and further limited the NAS that are allowed. The audit firms disagree with the policy, predictably.

Audit firms are organised as networks of limited liability partnerships sharing key common assets such as brand, training and research. Audit engagement for a client that operates across several jurisdictions is usually a syndicated effort of several partnerships, but appears to be supplied by just one firm. Similarly, NAS is usually not supplied by the audit partner, but by other partners within the same network. However, as all the partnerships are

Non-audit services involving management decisions, self-review, creating self-interest and advocacy are clear-cut threats to independence for which no safeguard would be deemed adequate by outside parties.
recognised by the same well-known brand name due to the successful marketing by major audit firms, the market does not perceive these partnerships as being independent even if they are different legal entities.

Moreover, depending on the specific NAS, the potential threat to audit independence varies. NAS is a heterogeneous group of services, and NAS involving management decisions, self-review, creating self-interest and advocacy are clear-cut threats to independence for which no safeguard would be deemed adequate by outside parties. For example, the provision by the incumbent auditor of these NAS, such as internal audit outsourcing, investment advisory, bookkeeping and so on, should be prohibited. Other NAS requires weighing the risk of the threat to independence against the safeguards instituted. The effectiveness of these safeguards, depending on existing internal governance of the firm and external enforcement and oversight mechanisms, varies according to the situation. As a result, the scope of restrictions on NAS imposed by each jurisdiction also varies significantly.

In a report commissioned by The Institute of Chartered Accountants in England and Wales in 2002, Beattie and Fearnley show that there is a set of NAS prohibited across all jurisdictions, but there are wide disagreements on prohibiting the other NAS among jurisdictions.

While reformers appear to be unanimous in prohibiting selected NAS and capping allowable NAS, audit firms contest the types of NAS prohibited and the rationale for the cap. Why would audit independence be compromised if the incumbent auditor provides NAS?

**ANALYTICAL ARGUMENTS**
The analytical arguments whether providing NAS compromises auditor’s
independence apply to the set of NAS that are not clear-cut threats.

There is no formal theory that links the provision of NAS, which is a diverse group of services after all, to the loss of auditor’s independence, though there are two main concerns. First, auditors become beholden to management because they wish to retain the additional income from NAS. Second, auditors identify too closely with management and lose their professional scepticism. The argument of reduced independence, that is, the independence hypothesis, means that NAS should not be allowed, or at least should be limited.

The counter-argument relies on the economies of scope, which refers to the proposition that joint provision of NAS with auditing has a lower cost than the separate provision of both services. Arrunada elaborates on two types of economies of scope - knowledge spillover and contractual economies. Knowledge spillover arises from the transfer of information and knowledge in the course of business of the two teams. Contractual economies arise from better use of resources, such as mutual trust and reputation, already developed when contracting with the client. Whether economies of scope are significant depends on the specific NAS, and whether specialised human resource is deployed. If there are significant economies of scope, the sensible policy is not to prohibit or limit NAS.

Both analytical arguments appear plausible and therefore pose a difficult policy decision. We next examine empirical evidence given the analytical context.

**EMPIRICAL EVIDENCE**

(a) Auditor’s Independence

The empirical literature in the NAS-independence relation can be divided into two streams. The older stream examines perceived independence, that is, independence-in-appearance, through mostly surveys and stock price reaction. The newer stream examines real independence, that is, independence-in-fact, using audit quality as proxy. Both aspects are required in the concept of auditor’s independence in the ethics code.

Generally, survey studies and studies of market reaction to unexpected earnings news both show that providing NAS reduces perceived independence. There is good consensus for reduced perceived independence.

Evidence on impairment of auditor’s real independence, which infringes ethical codes and regulations, is very hard to obtain.

The study by Frankel, Johnson, and Nelson shows that high NAS prices reduce real independence. However, subsequent studies, such as by Ashbaugh, LaFond and Mayhew, show that this result is not robust and is sensitive to the sample and measure of audit quality used. Hence, there is no consensus that provision of NAS impairs real independence.

(b) Economies of Scope

There is mixed empirical evidence on the economies of scope for the incumbent auditor to provide NAS. Starting from the seminal study by Simunic, a series of papers show that economies of scope exist between audit services and NAS.

However, a sophisticated study by Whisenant, Sankaraguruswamy and Raghunandan casts doubt on the earlier results. The study produces...
economies of scope are significant.

Empirical research for economies of scope will be increasingly difficult after SOX. This is because the data are difficult to obtain due to the prohibition of the incumbent auditor supplying most NAS. The definitive test for economies of scope is by examining the cost, but this requires proprietary cost data and being specific about the type of NAS.

CRUSHED BY THE BURDEN OF PROOF

This article discusses several issues in the debate on whether restricting the provision of NAS by the incumbent auditor is an optimal policy. We summarise the following four points before coming to a conclusion:

- NAS are not built equal in terms of threat to auditor’s independence. There is a consensus that the incumbent auditor should be prohibited from providing certain NAS. There is controversy over the prohibition outside this group of NAS.
- There is consensus that the incumbent auditor supplying NAS would lower perceived independence. This consensus is backed by empirical evidence.
- Real independence is almost impossible to prove. Using audit quality as proxy, the empirical evidence that provision of NAS lowers real independence is mixed.
- The evidence for economies of scope is mixed, and it appears that obtaining research data will be increasingly difficult after SOX.

Policy choice is often made using a cost-benefit framework. Evaluating the cost and benefit of the policy to restrict NAS should consider all the four points as a whole. The cost of a restrictive policy is the opportunity cost associated with foregoing potential economies of scope. The real benefit of the restrictive policy is the maintenance of real independence, and the apparent benefit is the maintenance of perceived independence. Empirical evidence for the cost and real benefit of the restrictive policy are both inconclusive. Many jurisdictions appear to have turned to the apparent benefit, which has empirical consensus, as the tie-breaker to favour a restrictive policy. Other jurisdictions, such as Singapore, choose to delegate the decision to the audit committees and regulate the auditors by incorporating a professional ethics code in the regulation for auditors.
Over the years, investors’ expectations of trusted financial information in promoting investment and economic growth have been rising, and audit quality becomes essential in meeting these expectations. To achieve a high quality audit, auditors ought to get the planning of an audit right, especially in areas which are more complex and require significant judgement. Engagement teams must ensure that adequate work is performed to address significant audit risks before forming their conclusions and issuing the right opinion. In this article, we discuss certain key audit considerations that should be relevant for the upcoming audit cycle to serve as a timely reminder for all auditors.

We identified some of the more judgemental or complex audit areas, including those that have recently been the subject of attention and focus by regulators. The following discussion should not be relied upon as definitive or all-inclusive, and should be read in conjunction with the applicable rules, standards and guidance in their entirety.

1 REVENUE RECOGNITION
Revenue is typically a significant account, often involving significant
risks that warrant special audit consideration, and is therefore a focus area in regulatory inspections. The following paragraphs discuss the application of the key requirements in the Singapore Standards on Auditing (SSA) that auditors should be mindful of when auditing revenue. Although the new accounting standard on revenue recognition will come into effect only in 2017, auditors should take the opportunity to engage management early to educate them on the potential impact of the new revenue standard, including evaluating the form and content of the financial statements disclosure.

Testing Revenue Recognition, Presentation and Disclosure

- Testing the recognition of revenue from contractual arrangements

To audit revenue, auditors should first understand the nature of the company’s principal businesses, the different types of sales or service contracts, and its controls over revenue including the company’s development of accounting estimates for project revenue. This also includes understanding the company’s key products, services and business processes that affect revenue, such as the key provisions of contractual arrangements and the extent to which contractual terms are standardised internally.

- Evaluating the presentation of revenue

When understanding the contractual terms of sales, it is important for auditors to evaluate whether the company is the principal or agent in the transactions. This evaluation will determine whether revenue is properly presented as gross or net.

- Testing whether revenue was recognised in the correct period

The risk of material misstatement arising from fraud or error results in improper revenue recognition.
Audit procedures, such as performing cut-off tests, should be specifically designed to address the risk of material misstatement related to revenue recorded in the incorrect accounting period.

**Evaluating the required financial statements disclosures**
Auditors should perform procedures to identify, assess, and address the risk of omitted, incomplete, or inaccurate disclosures. Qualitative considerations are especially important to the evaluation of misstatements in disclosures that are more narrative in nature.

**Other Aspects of Testing Revenue**

**Responding to fraud risks associated with revenue**
SSA 240 *The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements* requires auditors to presume that there is a fraud risk involving improper revenue recognition and to evaluate which types of revenue, revenue transactions, or assertions may give rise to such risks.

When responding to fraud risks, it is important to design and perform procedures that seek reliable evidence that would be difficult for potential perpetrators to manipulate, such as evidence obtained directly from independent and knowledgeable third-party sources. Additionally, incorporating an element of unpredictability in the audit procedures makes it more difficult for individuals looking to perpetrate a fraud to anticipate, and therefore, more difficult to conceal an intentional misstatement. Some examples of unpredictable audit procedures include selecting lower value items for testing and performing audit procedures on an unannounced basis.

**Performing substantive analytical procedures to test revenue**
Auditors should first evaluate whether management override of controls might have allowed fraudulent adjustments outside of the normal period-end financial reporting process to have been made to the financial statements.

Auditors should also assess the reliability of data used by considering the source of the data and the conditions under which it was gathered. Before using the results obtained from substantive analytical procedures, auditors should either test the design and operating effectiveness of controls over the financial information or perform other procedures to support the completeness and accuracy of the underlying information.

Performance of substantive analytical procedures involves comparisons of relationships and trends. When unusual fluctuations cannot be explained, auditors are required to perform additional audit procedures in response to significant unexpected differences.

**Testing revenue in companies with multiple locations**
When a company has operations in multiple locations or has multiple business units, auditors are required to determine the extent to which audit procedures should be performed at selected locations or business units in gathering sufficient audit evidence. Factors relevant to the assessment include materiality of location or risks of material misstatement associated with the location, individually or in aggregate, when applied to the company as a whole.

**AUDITING ACCOUNTING ESTIMATES, INCLUDING FAIR VALUE MEASUREMENTS**
When auditing accounting estimates, including fair value measurements, auditors are responsible for evaluating how accounting estimates have been developed, assessing the reasonableness of accounting estimates made by management in the circumstances, assessing whether they are presented in conformity with applicable accounting principles, and are appropriately disclosed. Examples of management estimates may include those related to purchase price allocations, impairment assessments, allowance for doubtful accounts, and uncertain tax positions.

In evaluating the reasonableness of management’s estimates, auditors should obtain an understanding of how management developed the estimate and use one or a combination of the following approaches:
- Review and test the process used by management to develop the estimate;
- Develop an independent expectation of the estimate to corroborate the reasonableness of management’s estimate, and
- Review subsequent events or transactions occurring prior to the date of the auditor’s report.

Auditors should focus on key inputs and assumptions that are:
- Significant to the accounting estimate;
Auditors are required to plan and perform their work with professional competence and due care, which requires auditors to exercise professional scepticism throughout the audit process, including in those areas of the audit that involve significant management judgements and transactions that are outside the normal course of business. In exercising professional scepticism, auditors should not be satisfied with less-than-persuasive evidence because of a belief that management is honest. For example, when applying professional scepticism, auditors should (a) modify the planned audit procedures to obtain more reliable evidence regarding relevant assertions, and (b) obtain sufficient appropriate evidence (for example, third-party confirmations and examination of documentation from independent sources).

The engagement partner is responsible for setting an appropriate tone that emphasises the need to maintain a questioning mind throughout the audit and to exercise professional scepticism in gathering and evaluating evidence so that engagement team members have the confidence to challenge management representations. The engagement partner and other senior engagement team members should also be involved in planning, directing, and reviewing the work of other engagement team members so that matters requiring audit attention, such as unusual matters or inconsistencies in audit evidence, are identified in a timely manner, and addressed appropriately.

Professional scepticism involves, among other things, considering what can go wrong with the financial statements, performing audit procedures to obtain sufficient appropriate audit evidence (rather than merely obtaining the most readily available evidence to corroborate management’s assertions), and critically evaluating all evidence regardless of whether it corroborates or contradicts management’s assertions.

**CONCLUSION**

While the above considerations may appear intuitive, it does not hurt to be reminded of the basic audit principles which are fundamental to audit quality. Strengthening audit quality is the key to mitigating the risk of issuing a wrong audit opinion; it pays to get it right from the start. ISCA

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Zoey Xie is Manager, Technical Standards Development & Advisory, ISCA. The article is adapted from “Select Auditing Considerations for the 2014 Audit Cycle”, Center for Audit Quality’s Alert #2014-13, with permission.
FINANCIAL REPORTING

ISCA ISSUES COMMENT LETTER ON RECOGNITION OF DEFERRED TAX ASSETS FOR UNREALISED LOSSES

ISCA agrees with the proposed amendments as they provide clarity on what constitutes future available taxable profits against which a deductible temporary difference can be utilised.


NEW FINANCIAL REPORTING STANDARDS AND AMENDMENTS TO FINANCIAL REPORTING STANDARDS

• FRS 109 Financial Instruments
  The Accounting Standards Council (ASC) has issued FRS 109 which will be effective for annual periods beginning on or after 1 January 2018. Earlier application is permitted.
  For more information, please visit www.asc.gov.sg/CEPafter1Jan2014

• SFRS for Small Entities Q&A No. 5
  ASC has issued SFRS for Small Entities Q&A No. 5 Fallback to FRS 109 Financial Instruments to clarify that small entities are not permitted to apply FRS 109.
  For more information, please visit www.asc.gov.sg/SFRS-for-Small-Entities

• Amendments to IAS 1
  Presentation of Financial Statements
  IASB has issued amendments to further encourage companies to apply professional judgement in determining what information to disclose in their financial statements. The amendments clarify that companies should use professional judgement in determining where and in what order information is presented in the financial disclosures.
  For more information, please visit www.ifrs.org/Alerts/Publication/Pages/IASB-makes-progress-on-improving-the-effectiveness-of-disclosure-in-financial-reporting-December-2014.aspx

• Amendments to IFRS 10, IFRS 12 and IAS 28
  IASB has issued narrow-scope amendments which introduce clarifications to the requirements when accounting for investment entities and providing relief in particular circumstances. The amendments can be applied immediately and become mandatory for annual periods beginning on or after 1 January 2016.
  For more information, please visit www.ifrs.org/Alerts/Publication/Pages/IASB-publishes-narrow-scope-amendments-to-investment-entity-requirements-December-2014.aspx

IAASB PUBLISHES ED FOR PUBLIC COMMENTS

• ED Classification and Measurement of Share-based Payments (Comments due on 25 March 2015)
  IASB proposes three amendments to the classification and measurement requirements in IFRS 2 Share-based Payments.
  For more information, please visit www.ifrs.org/Alerts/Publication/Pages/IASB-publishes-Exposure-Draft-proposing-amendments-to-IFRS-2-Share-based-Payment-November-2014.aspx

• ED Disclosure Initiatives (Comments due on 17 April 2015)
  As part of IASB’s Disclosure Initiative, this ED proposes improved disclosures about an entity’s financing activities and its cash and cash equivalents balances in IAS 7 Cash Flow Statements.
  For more information, please visit www.ifrs.org/Alerts/Publication/Pages/IASB-makes-progress-on-improving-the-effectiveness-of-disclosure-in-financial-reporting-December-2014.aspx

AUDITING AND ASSURANCE

IAASB RELEASES NEW STRATEGY AND WORK PLAN

The Strategy and Work Plan illustrates IAASB’s continuing commitment to strengthen public confidence in financial reporting and contribute to the ongoing relevance of the financial statement audit, while staying abreast of emerging developments to ensure its work addresses pertinent public interest matters relevant to its wide range of stakeholders.

For more information, please visit www.ifac.org/news-events/2014-12/iaasb-continues-focus-audit-quality-and-strengthening-public-confidence-financia

ETHICS

ISCA ISSUES COMMENT LETTER ON IESBA ED PROPOSED CHANGES TO CERTAIN PROVISIONS OF THE CODE ADDRESSING THE LONG ASSOCIATION OF PERSONNEL WITH AN AUDIT OR ASSURANCE CLIENT

While ISCA generally agrees with all the proposals in the ED, ISCA has also urged IESBA to give more consideration to the practical challenges faced by SMPs when applying the proposed changes. ISCA has also noted that it may be worthwhile for IESBA to establish a platform for different jurisdictions to share how they are preparing their SMPs for the changes.

Automating Order Data Entry for Greater Productivity

**HIGHLIGHTS**
- Industry: Wholesaling
- Location: Singapore
- Solution: Integration of third-party solution with Sage 300 ERP
- Results:
  - Elimination of manual data entry errors
  - Greater productivity
  - Enhanced response time to meet customers' demands

**CHALLENGE**
As a leading fruits and vegetables wholesaler in Singapore, the client has to process voluminous orders quickly and accurately to meet its customers’ demands. All orders are placed through an online supply chain portal that allows F&B establishments to do e-business and email purchase orders to sellers.

Upon receipt of the purchase order, the client had to manually duplicate it into Sage 300 ERP, which resulted in:
- High chance of human errors during the manual data entry process, leading to incidences such as delivery of wrong goods to customers
- Much time spent to validate the incoming data, negatively impacting productivity

In response, the client approached Stone Forest IT (SFIT) for a solution to automate the transfer of data from the supply chain portal to Sage 300 ERP.

**RESULTS**
Following the integration, the client has:
- Eliminated manual data entry errors
- Been able to focus more on core business activities and increase productivity
- Enhanced response time to meet customers’ demands

The successful integration is a result of SFIT’s extensive experience in integrating third-party solutions with Sage 300 ERP to meet specific business needs.

**SOLUTION**
SFIT worked closely with the supply chain portal’s vendor to integrate the portal with the client’s Sage 300 ERP system. This provided the following capabilities:

- Introduction of a customised utility that converts data from incoming purchase order email attachments into sales order records. This allows the client to directly upload the attachments into Sage 300 ERP without the need for manual data entry.
- The utility also generates invoices according to the sales order records and automatically sends them to the supply chain portal, which forwards them to the buyers by email.
against the backdrop of Asia’s fast-growing markets, tax functions are facing a number of challenges. To name a few, these include changes to the tax legislation, complex and unpredictable legislation, aggressive tax authorities focused on their budgets, and management expecting the tax function to add value with decreasing resources.

These demands are placing great pressure on tax executives, but they also provide opportunities for them to transform their functions into coordinated or even centralised, automated and streamlined profit centres. For this purpose, they should evaluate the current state of their function to close the gap with best practices.

This article analyses some of the challenges followed by the opportunities that drive the transformation of tax functions. Based on this analysis, the article shares ideas on how to close the gap between the status quo and desired future state. While this article focuses primarily on larger multinational companies (MNCs), the pressure on less sophisticated small and medium-sized enterprises (SME) looking to expand across borders would be even higher.

EXTERNAL CHALLENGES
The Foreign Direct Investment (FDI) Report 2014 shows that in 2013,
Asia Pacific remained the leading destination for FDI. In addition, Asia Pacific has also increased its outbound investments. The substantial growth, inbound and outbound, has posed unprecedented challenges.

a) Rapid change in tax regulations
In response to today’s changes, governments have to adapt and govern their tax jurisdictions. To implement new laws, governments need time. This has led to tax policies not keeping pace with business development, or hastily-made policies which lack clarity or contain contradictions. A Deloitte survey in December 2012 revealed that in Asia Pacific, 34% of respondents feel that regional tax regimes have become more complex over the past years.

b) More aggressive tax authorities
Since the last financial crisis, tax authorities have become more aggressive in increasing their taxable base.

c) Increased level of public scrutiny
Tax functions are under the spotlight in the wake of media coverage on a number of MNCs’ tax affairs. Such negative media coverage, which often lacks objectivity, can seriously impair a firm’s reputation.

d) BEPS implications
Currently, one of the hottest topics in the tax landscape is the Organisation for Economic Cooperation and Development (OECD)’s Base Erosion and Profit Shifting (BEPS) project. BEPS is looking into the current tax rules to see whether they allow for the allocation of taxable profits to low- or no-tax jurisdictions.

In July 2013, OECD launched an Action Plan on BEPS which requires developing a multilateral instrument.

to amend bilateral treaties. This will result in significant changes in how MNCs are taxed globally. On top of the potential tax exposure, this will increase the high administrative burden on companies active in multiple jurisdictions.

**INTERNAL CHALLENGES**

**a) Business expects more from the tax department**

Tax remains a key consideration for investment in Asia. C-level executives expect more from their tax functions to enhance their decision-making. They want the tax function to be strategic, agile and focused on creating value. This requires tax executives to provide leadership in determining strategic direction and to align with business strategies.

**b) Tax risk mitigation**

Not only may non-compliance lead to penalties, inaccurate reporting may also be penalised by the stock market. Tax risk management has become a paramount task for tax executives. They are required to develop tax risk management policies and to monitor, evaluate and mitigate risks.

**c) Shareholder demand**

Shareholders are concerned whether companies are paying the right amount of tax. They do not want their investments to be jeopardised by non-compliance. On the other hand, they do not want their return on investment to decrease because of undue taxes.

**d) Resource availability**

Although the market has a large pool of tax talents, tax executives face difficulties in attracting top talent. With limited resources, executives are required to run their tax department effectively and efficiently.

**OPPORTUNITIES**

In Asia, tax functions are addressing these challenges with disparate degrees of success. Some still struggle to get their returns filed, while others have transformed the role of their traditional tax functions to a more strategic one.

This provides a great opportunity for tax executives to improve their functions’ performance. By leveraging best practices, they could make the tax functions more visible and involved in the business.

**TAX FUNCTIONS**

In Asia Pacific, the majority of executives involved in tax functions spend most of their time and resources on compliance matters. As a result, they are unable to allocate resources to high-value activities. They do not have a strategy, or their strategy is not aligned with the business. This makes tax performance deviate from the management’s expectation.

At the operational level, Asia-Pacific tax functions have not kept pace with today’s requirements, and many share these common characteristics:

- Key performance indicators (KPIs) for performance measurement are not defined;
- The tax functions are decentralised;
- Tax compliance processes are not documented, not standardised;
- Tax returns are prepared manually, tax software is not widely adopted.

**TAX BEST PRACTICES**

The best tax functions have the following characteristics:

- A clearly defined strategy, governance, roles and responsibilities, aligned with the business and finance strategy;
- Standardised compliance and reporting processes by tax type, business division and/or function;
- Solid infrastructures supporting activities and monitoring controls across organisation, people, data, systems and risk.

Figure 1 shows the differences between a “good” tax function and one that employs “best” practices.

**HOW TO GET THERE**

**a) Four steps towards tax best practices**

1. Assess the current state of the tax function;
2. Determine the desired future state with a clear vision aligned with the commercial strategy;
3. Identify the steps required to reach that future state;
4. Prioritise the required steps in line with business and tax strategies.

To ensure that the progress of the transformation is tracked, a series of KPIs should be implemented. This requires a change management plan to ensure the participation of all stakeholders.

**b) Reduce time on routine work**

- Streamline processes to free up resources

A centralised approach can be adopted for the bulk of tax compliance work. Another approach is to outsource or co-source the routine activities to external service providers.

- Improve data quality and control

A greater level of quality would facilitate compliance and planning. Tax executives should assess the data quality for compliance and planning, and then work with finance, business and IT towards improvements.

C-level executives expect more from their tax functions to enhance their decision-making. They want the tax function to be strategic, agile and focused on creating value. This requires tax executives to provide leadership in determining strategic direction and to align with business strategies.
Increased quality and control give tax executives greater confidence.

**Make best use of technology**
One should make the best use of technology, for example, the use of specialist return and data processing tools, mix of specialist tools that are compatible and integrated to streamline data flows.

**c) Increase time on strategic issues**
The importance of formulating and aligning the tax strategy with the commercial vision and strategy cannot be over-emphasised. Tax executives should agree on the tax strategy with key stakeholders within the business, and work closely with the business to understand their expectations. Tax functions should also improve their capacity to respond to business needs and identify key events ahead of time and allocate the appropriate resources. Last but not least, tax functions should invest in building strong relationships with their stakeholders through communication of shared values and successes.

**CONCLUSION**
"If you don’t drive your business, you will be driven out of business.” The oft-used quote of Forbes magazine founder, the late B.C. Forbes, should be heeded.

Tax executives must be proactive in meeting external and internal challenges to drive change. Otherwise, they risk having change forced upon them with no control over the outcome. As a profit centre, tax functions have to become more efficient and effective in tax management, and play a more strategic role in the management and overall performance of the business. Ultimately, management will invest more in the tax functions’ future growth.

Rony Wuytjens is Managing Director, Global Tax Centre Asia, Deloitte Southeast Asia.
In this article, our focus is on a resident company. Specified foreign income refers to foreign sourced dividend income, foreign sourced branch profit and foreign sourced service income.

1 In this article, our focus is on a resident company.
2 Specified foreign income refers to foreign sourced dividend income, foreign sourced branch profit and foreign sourced service income.
3 Elected income means any item of foreign income for which a resident person qualifies to claim the foreign tax credit under the PS.
### Table 1 Tax computation for Company A receiving foreign income

<table>
<thead>
<tr>
<th>Description</th>
<th>A</th>
<th>B1</th>
<th>B2</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>FDI tax exempt under the FSIE</strong></td>
<td>FDI tax subject to Singapore tax and FTC claimed in respect of the FDI</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Foreign tax rate on Dividend income</td>
<td>-</td>
<td>10%</td>
<td>30%</td>
</tr>
<tr>
<td>Local trade income</td>
<td>$3,000,000</td>
<td>$3,000,000</td>
<td>$3,000,000</td>
</tr>
<tr>
<td><strong>Foreign income:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest income (FTP @ 8%, that is, $800)</td>
<td>10,000</td>
<td>10,000</td>
<td>10,000</td>
</tr>
<tr>
<td>Royalty income (FTP @ 5%, that is, $100,000)</td>
<td>2,000,000</td>
<td>2,000,000</td>
<td>2,000,000</td>
</tr>
<tr>
<td>FDI (exempt under the FSIE regime)</td>
<td>0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>FDI (FTP @ 10%, that is, $500,000)</td>
<td>5,000,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>FDI (FTP @ 30%, that is, $1,500,000)</td>
<td></td>
<td></td>
<td>5,000,000</td>
</tr>
<tr>
<td>Net chargeable Income before Partial tax exemption</td>
<td>X 5,010,000</td>
<td>10,010,000</td>
<td>10,010,000</td>
</tr>
<tr>
<td>Less: Partial tax exemption</td>
<td>152,500</td>
<td>152,500</td>
<td>152,500</td>
</tr>
<tr>
<td>Normal chargeable income after Partial tax exemption</td>
<td>4,857,500</td>
<td>8,857,500</td>
<td>8,857,500</td>
</tr>
<tr>
<td>Tax payable before FTC (@ 17%)</td>
<td>Y 825,775</td>
<td>1,675,775</td>
<td>1,675,775</td>
</tr>
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<td>Less: FTC - lower of pooled FTP of $100,800, that is, ($800 + $100,000) and pooled STP of $331,299&lt;sup&gt;4&lt;/sup&gt;</td>
<td>100,800</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Less: FTC - lower of pooled FTP of $600,800, that is, ($800 + $100,000 + $500,000) and pooled STP of $1,173,545&lt;sup&gt;5&lt;/sup&gt;</td>
<td>600,800</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Less: FTC - lower of pooled FTP $1,600,800 , that is, ($800 + $100,000 + $1,500,000) and pooled STP of $1,173,545&lt;sup&gt;5&lt;/sup&gt;</td>
<td></td>
<td>1,173,545</td>
<td></td>
</tr>
<tr>
<td>Net tax payable after FTC</td>
<td>724,975</td>
<td>1,074,975</td>
<td>502,230</td>
</tr>
<tr>
<td>Less: Net tax payable (without FDI)</td>
<td>724,975</td>
<td>724,975</td>
<td>724,975</td>
</tr>
<tr>
<td>Increase/(Decrease) in net tax payable due to the inclusion of FDI</td>
<td>350,000</td>
<td>(222,745)</td>
<td></td>
</tr>
<tr>
<td>Excess of pooled FTP over pooled STP disregarded</td>
<td>0&lt;sup&gt;6&lt;/sup&gt;</td>
<td>0&lt;sup&gt;7&lt;/sup&gt;</td>
<td>427,255&lt;sup&gt;8&lt;/sup&gt;</td>
</tr>
<tr>
<td>Excess of pooled STP over pooled FTP</td>
<td>230,499</td>
<td>572,745</td>
<td>0</td>
</tr>
<tr>
<td>Singapore effective tax rate</td>
<td>Y/X 16.48253%</td>
<td>16.74101%</td>
<td></td>
</tr>
</tbody>
</table>

<sup>4</sup> ($10,000 + $2,000,000) x Singapore effective tax rate of 16.48253%
<sup>5</sup> ($10,000 + $2,000,000 + $5,000,000) x Singapore effective tax rate of 16.74101%
<sup>6</sup> FTP of $100,800 less FTC granted of $100,800
<sup>7</sup> FTP of $600,800 less FTC granted of $600,800
<sup>8</sup> FTP of $1,600,800 less FTC granted of $1,173,545
<sup>9</sup> $1,675,775 less $825,775
<sup>10</sup> $600,800 less $100,800
<sup>11</sup> $1,173,545 less $100,800
<sup>12</sup> Alternatively, $5,000,000 x Marginal Rate of 17% = $850,000
<sup>13</sup> ($10,000 + $2,000,000) x Singapore effective tax rate of 16.74101% less pooled FTP of $100,800

**ANALYSIS OF TABLE 1**

1) By including the foreign dividend income of $5 million as a taxable income (in scenarios B1 and B2, the overall tax payable before foreign tax credit will increase by $850,000<sup>9</sup> as compared to scenario A.

2) Consequently, the amount of pooled foreign tax credit granted under the PS will increase by $500,000<sup>10</sup> in scenario B1, and $1,072,745<sup>11</sup> in scenario B2.

3) Depending on the extent of the increase in (1) and (2), the net tax payable after the pooled foreign tax credit may increase or decrease. In scenario B1, it will increase by $350,000 ($850,000 - $500,000), but in scenario B2, it will decrease by $222,745 ($850,000 - $1,072,745).

4) Claiming exemption on the foreign dividend income under the FSIE regime in scenario A is more tax beneficial than subjecting it to tax....
in scenario B1. Although there is an excess of the STP over the FTP in respect of the foreign interest and royalty incomes, the inclusion of the foreign dividend income does not give rise to an excess of FTP over STP that Company A can utilise under the PS.

5) In scenario B2, the inclusion of the foreign dividend income gives rise to an excess of FTP over STP that Company A can utilise under the PS to further increase the amount of pooled foreign tax credit granted. Overall, by not claiming tax exemption on the foreign dividend income under the FSIE regime, Company A can enjoy further tax savings of $222,745. This is explained as follows:

## Inclusion of foreign dividend income of $5,000,000 results in an

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount ($)</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) Increase in tax payable before FTC</td>
<td>850,000(^{12})</td>
</tr>
<tr>
<td>(b) Increase in FTC granted of $837,051, being the lower of STP of $837,051 (that is, foreign dividend income of $5,000,000 x 16.74101%) and FTP of $1,500,000 thus giving rise to an excess of FTP over STP of $662,949</td>
<td>837,051</td>
</tr>
<tr>
<td>Additional tax payable [(a) - (b)]</td>
<td>12,949</td>
</tr>
<tr>
<td>(c) Excess of FTP over STP ($662,929) in respect of the foreign dividend income, which can be utilised to offset against the excess of pooled STP over pooled FTP in (d) below.</td>
<td>662,929</td>
</tr>
<tr>
<td>In respect of the total foreign interest income and royalty income of $2,010,000</td>
<td></td>
</tr>
<tr>
<td>(d) the excess of the pooled STP over the pooled FTP</td>
<td>235,694(^{13})</td>
</tr>
<tr>
<td>Additional FTC granted as a result of including the foreign dividend income - lower of (c) and (d)</td>
<td>(235,694)</td>
</tr>
<tr>
<td>Additional tax savings</td>
<td>222,745</td>
</tr>
</tbody>
</table>

## CONCLUSION

Generally, if a specified foreign income which qualifies for tax exemption under the FSIE regime also meets the conditions qualifying for the foreign tax credit under the PS, tax exemption under the FSIE regime is usually beneficial unless:

1) Prior to the inclusion of the specified foreign income, there is already an excess of pooled STP over the pooled FTP, and
2) FTP in respect of the specified foreign income is greater than its STP.

The idea here is to be able to utilise the excess in (2) to offset against the excess in (1). This effectively means an overall higher amount of pooled foreign tax credit granted in the end.

However, with the inclusion of taxable foreign dividend income, overall tax payable before foreign tax credit also increases. At this point, one has to compare the extent of the increase in the overall tax payable before foreign tax credit with the extent of the increase in the overall amount of pooled foreign tax credit granted after the inclusion of the foreign dividend income. This is when one needs to test out the “beneficial tax exemption” condition under the FSIE regime by comparing the two different sets of tax computations, that is, tax exemption versus non-tax exemption.

In our illustration, we conclude that it is more tax beneficial for Company A to claim tax exemption under the FSIE regime in respect of its foreign dividend income under scenario B1, when the foreign tax rate is 10%. However, under scenario B2, Company A is better off by not claiming tax exemption when the foreign tax rate on the foreign dividend income is 30% as there are additional tax savings of $222,745.

In this article, the entire amount of foreign dividend income is treated as either being tax exempt under the FSIE regime or taxable under the PS. In our next article, we will extend our analysis in scenario B2 further by varying the portion of foreign dividend income that is treated as tax exempt under the FSIE regime and the remaining portion as taxable under the PS. In doing so, we will determine if Company A is able to further optimise its tax position. ISCA

Clement Tan Kai Guan is Associate Professor of Accounting, Nanyang Business School, Nanyang Technological University, and Khoo Teng Aun is Associate Professor of Accounting, Singapore Management University.
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**QUIZ**

1. In “Battling Money Laundering”, the ISCA-developed EP 200 has been adopted by ACRA to help public accountants and accounting firms strengthen their anti-money laundering regime.
   A True
   B Maybe
   C False

2. In “Convertible Bond’s Conversion Options”, a financial instrument that comprises straight debt and a conversion option that is classified as equity is recognised as a compound instrument, that is, it is a liability with an equity component.
   A True
   B Maybe
   C False

3. In “Considerations for Audit Cycle”, professional scepticism is not necessary if there is ready evidence to corroborate the company management’s assertions.
   A True
   B Maybe
   C False

Stand to win the book of your choice! Simply email your answers to the quiz questions to comms@isca.org.sg by 26 February 2015. Please provide your full name, NRIC number, mailing address, contact number and the book you’re interested in.

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<table>
<thead>
<tr>
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<th>Tan Boon Heng Kelvin</th>
<th>Martin Ho Tze Cheng</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Sxxx9867-E</td>
<td>Sxxx0062-H</td>
<td>Sxxx956-C</td>
</tr>
</tbody>
</table>

Answers for the January quiz: (1) B, (2) A, (3) C
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