Mergers & Affiliations

McMillan Woods

11 June 2015

Kota Kinabalu, Sabah

Professionalism at the forefront

Disclaimer

These handouts are presented with the understanding that the author and/or presenter is not responsible for the results of any actions taken on the basis of the information contained in these handouts, nor for any errors or omissions.

The author and/or presenter expressly disclaims all and any liability to any person, whether participants attending the presentation and/or receiving these handouts and/or purchasers of the presentation information or not, in respect of anything and of the consequences of anything done or omitted to be done by any such person in reliance, whether as a whole or partial, upon the whole or any part of the contents of these handouts.

If legal advice or other expert assistance is required, the service of a competent professional person should be sought.

www.mcmillanwoods.com

Synopsis

The message is clear…. Change of be changed!

The time is never right but certainly with the rapid evolutionary changes in the accounting profession, it is timely for you to get-together and to take advantage of the many opportunities to embark in a strong affiliation arrangement for growth potentials. Certainly, using the affiliation tools to build a solid foundation for global growth and subsequently progress into a merger arrangement is a long term strategy.

Mergers & Affiliation is termed as **Affiliation,** Acquisition & Merger (**AAM**), as a tool for growth potentials and this seminar is aimed to provide an insight into some of the key global trends affecting the accounting and audit profession.

Main objectives

- To provide you as a member in public practice with critical understanding of the changing regulatory landscape and emerging trends across the accounting profession; and
- To provide members in public practice to capitalise on the opportunity for using AAM as a prominent economic vehicle for growth potential.

Seminar methodologies

A presentation to reflect the past years' development in the capital market and the auditing standards reform, which serves as a platform for the affiliation, acquisition and merger surge. One will gain valuable insights on the myths, tips and pitfalls for a successful affiliation, acquisition and/or merger arrangement.

Forthcoming new change ...to the role of Auditors

Game changer…

Effective 15 December 2016

18 months from now, new and revised standards of auditors' report kick in – The Star 6 June 2015

Auditors' Report – New changes

Errol Oh optimistically cautious

starbiz@thestar.com.my

Can auditors be insightful, transparent?

New standards introduce changes to increase value of audit reports

WOULD you perk up if told that the independent auditor's report – most of us know it as those two pages in a company's annual financial statements in which the auditors give their opinion on the accounts – would be very different 18 months from now? Probably not. From time to time, the spotlights swivels to the auditors when people question the reliability of audited corporate results, but we are otherwise indifferent to what the auditors do.

Try this instead: What if a regulator believes that the upcoming development may be a game changer? Is that enough to arouse our curiosity?

Hopefully. The revamp of the international auditor reporting standards is meant to make the auditor's report more useful to investors and others who use the audited financial statements. If we don't care about the new format, this implies that we don't value what the auditors have to say.

The Audit Oversight Board (AOB) certainly thinks we should be looking forward to the improved auditor's report.

In his message in the board's annual report 2014, issued on Tuesday, executive chairman Nik Hasyudeen Yusoff says, "We view the implementation of the new and revised auditor reporting standards as a possible game changer to enhance the quality of financial reporting in Malaysia. All stakeholders have to be involved to ensure smooth implementation of these standards."

The International Auditing and Assurance Standards Board (IAASB), the New York-based independent body that sets the auditing standards, says those standards were reviewed because the market wants a more informative auditor's report, which is the most visible outcome of an audit. To be precise, the accounts users have asked for "more relevant information".

"Research, public consultations, and stakeholder outreach, including global roundtables, indicate that enhanced auditor reporting is critical to influencing the perceived value of the financial statement audit," says the IAASB.

> **The intent is to introduce into auditor's reports a bespoke description of key areas of focus in the audit – in a sense, a window into what kept the auditor up at night.**
>
> PricewaterhouseCoopers

In a TV interview last month, IAASB chairman Prof Arnold Schilder explained, "Auditor reporting in the future will become much more informative to outside users that so far didn't hear anything from the auditor except the final conclusion, the auditor's opinion. In the future, you will see five, six pages with unique information coming from the auditor about the audit and that's very relevant to users of that information."

In this context, the future begins on Dec 15 next year, which is when the new and revised standards take effect.

Yes, we get it, there will be more information. But what exactly?

Some of the changes sound minor. The name of the engagement partner has to be disclosed. The audit opinion must be presented before the auditor explains the basis of that opinion. There needs to be an explicit statement of auditor independence and fulfilment of relevant ethical responsiblities. There will also be an enhanced description of the auditor's responsibilities and key features of an audit.

But the change that the audit fraternity often discusses is the introduction of a section on "key audit matters". PricewaterhouseCoopers (PwC) calls it "the most significant innovation in the new standards".

Key audit matters

According to the IAASB, key audit matters are "those matters that, in the auditor's judgment, were of most significance in the audit of the current period financial statements". KPMG has helpfully interpreted this as the areas that the auditor worried about and focused on the most during the audit.

Says PwC, "The intent is to introduce into auditor's reports a bespoke description of key areas of focus in the audit – in a sense, a window into what kept the auditor up at night. This won't supplant the auditor's opinion on the financial statements as a whole, which investors value, but it expands the report by asking auditors to describe what the significant issues were, why they were significant, and how they addressed them."

The Big Four firm adds that in Britain, where similar proposals have been rolled out, auditors have embraced the transformation. As a result, says Richard Sexton, PwC vice-chairman of global assurance, they have produced insightful reports with tailored information and less jargon. "Shareholder reaction has been very positive, referring to a 'sea change' in auditor reporting. This is a good start."

Will Malaysia have a good start as well? As Nik Hasyudeen points out in the AOB's latest annual report, the existing format of the auditor's report is largely a collection of standard terms and boilerplate disclosures. We need to know more.

But it's not about increasing the number of words and pages. Some of us have the knack of saying plenty without revealing much. Also, too much content can be a put-off.

Offering insights

For the new auditor's report to be a true game changer, the auditors must believe in the benefits of the reform. They need to offer insights rather than only passing on the bare facts. They ought to be transparent and communicative instead of cold and taciturn.

It has always been difficult to convince people that they're getting value for money when they pay audit fees. Getting the new auditor's report right may change that.

Executive editor Errol Oh needs to take a break from writing on audits.

Professionalism at the forefront

☹ The need to know…

24 focus

SUNDAY STAR

Too poor to retire

Concerned that an alarmingly high number of 54-year-old Malaysians have less than RM50,000 in their EPF savings, the fund for private sector employees will reveal tomorrow its policy proposals that will allow retirees to live comfortably.

By CHRISTINA CHIN
sunday@thestar.com.my
Photos by SAM THAM

EAGER to impress his relatives and friends, Jerry Chung's father wiped out his entire Employees Provident Fund (EPF) savings to pay for his eldest son's wedding banquet.

"My father worked as a night club supervisor for a short time so his savings wasn't a lot. He had about RM25,000 which he withdrew at age 55 for my wedding. He is doing odd-jobs now because we don't have enough to get by," the 27-year-old hawker shares.

Blowing their savings on lavish weddings, home renovations and poor investments, are just some of the reasons why retirees are forced back into the workforce in their golden years.

EPF deputy chief executive officer (strategy) Tunku Alizakri Alias says globally, the trend is for people to spend their hard earned savings on holidays and cars.

He is concerned about the "instant gratification generation" and feels that financial literacy is still low among Malaysians.

"Wake up. Be aware of your retirement needs. EPF should not be your only source of retirement funds. You must have insurance and your own savings too," he advises.

Explaining the urgent push for a higher withdrawal age from the current 55 years to 60 years - a proposal recently mooted by the EPF - he says it is because the need is pressing.

He describes the sandwich generation phenomenon (adults who are supporting their parents and their own children) as a "time bomb" that needs to be addressed immediately.

With rising costs, double income households are the reality of modern living, he adds.

"The worst case scenario has already happened.

"Last Tuesday, The Star Online reported that a 66-year-old former lab technician was chased out of his own home after he transferred property and savings to a family member," he says.

Addressing doubts about how much difference five years can make, he says members can earn 20% to 35% more if they keep their savings with the EPF until age 60.

"The longer you save, the more your money will grow. Why lose out on your money's compounding power?"

The fact that we will be an 'aged nation' by year 2030 is a challenge, especially when Malaysians are retiring at a relatively younger age than their counterparts around the world, he points out.

In Singapore, Australia, Denmark and Germany, he says, the people work past 60 while in countries like Canada and Norway, the retirement age is above 65.

The EPF, which currently has 14,192,832 members, recommends having at least RM196,800 in basic savings upon retirement, but only 22% of its active 54-year-old contributors met this minimum last year.

"This is not the 1950s where people die before they can withdraw their EPF at age 55.

"People are living past 100 now. On average, you need your retirement savings to last for at least 20 years beyond retirement. The quality of life starts to deteriorate at age 65 and that's when you'll really need money," he says.

Financial security is a major issue that needs immediate tackling, National Council of Senior Citizens Organisations Malaysia president Datuk Dr Soon Ting Kueh opines.

The council represents 41 senior citizen clubs nationwide. He says EPF savings alone is insufficient for most seniors, especially when a major illness hits.

"The most worrying are chronic lifestyle diseases like diabetes and hypertension that require long-term medication. With no income, how will the elderly cope?" he mulls, urging the Government to take into account the ageing population in its development plans.

Malaysian society has evolved, Universiti Malaya's Social Security Research Centre director Prof Datuk Dr Norma Mansor observes. She sees a break in the cultural and economic structure of the traditional family.

"We used to say that our kids are our insurance but that's no longer so today. Children are not only too busy to look after their parents, they may not have the means to do so. They need two salaries to raise a family, meaning that both husband and wife must work.

"Unlike the Westerners, we don't put responsibility on the Government to take care of our parents but still there should be policies that can support the new realities faced by families today."

Prof Dr Norma, who was the National Economic Advisory Council secretary-general, calls on the Government to quickly set up the National Social Security Taskforce to look at policy reforms holistically.

The taskforce will bring together all the relevant ministries to study the need for a robust social security infrastructure covering health, education, housing and retirement.

She says new policies are needed not just for retirees but also for the unemployed and self-employed.

"EPF is among the best (retirement fund managers) out there but there are issues such as low accumulation and high member withdrawals that must be addressed.

"If you withdraw your EPF and find that the returns are less outside, you can still put it back in," she suggests.

Malaysian Employers Federation executive director Datuk Shamsuddin Bardan believes that the withdrawal age should be in line with the retirement age which was increased to 60 in 2013.

He, however, cautions against raising Malaysia's mandatory EPF contribution rate.

He feels that the current EPF statutory contribution rate that employers pay, at 12% and 13% (for employees earning RM5,000 or less) and 11% by the employees, are sufficient.

The risk of longevity

Malaysians are living longer than their EPF savings can last.

68% of those aged 54 have <RM50,000

Female
Male

2015
2010
1990
1970
1950

Age 0 10 20 40 50 55 60 70 75 80

55: Full lump-sum withdrawal (accounts 1 + 2)

60: Assuming that the members spend RM830 per month, RM50,000 can only last for 5 years

75: With average life expectancy at ±75 years old, most Malaysian do not have enough savings to retire at age 60

©THE STAR GRAPHICS

Some of the approved withdrawals in 2014

Investment 439,723
Housing 382,214
Age 50 147,991
Health 5,136
Education 77,404

Total withdrawals RM33.78bil

☞ Recent news report indicates that in general, the public is too poor to retire. Why?

My question to you…

Is EPF alone sufficient to enable us, practitioners to retire and enjoy the same life style as we are currently enjoying?

Or are we enjoying our lifestyle?

Professionalism at the forefront

☹The need to know…

- According to statistics from the Employees Provident Fund, **80% of Malaysian employees who will turn 55 this year will not have enough savings in their pension funds when they retire.**

- Is this not alarming!?

- As practitioners, how then do we attain financial security in our later years?

- When it comes to succession or retirement planning, there are typically 4 areas to bear in mind:

  - Wealth creation
  - Wealth accumulation
  - Wealth protection
  - Wealth distribution

This is certainly, not a financial planning discussion but how we practitioners can help to safeguard what we have painfully **created**, **accumulated** and now, watchfully wanting to **protect** and **distribute** our hard earn wealth to our loved ones!

Unlock the value of your practice ..with happy thoughts

Welcome to today. Another day, another chance. Feel free to change.

Many of us are often wondering….

What is the value of my practice?

☹The need to know…

As practitioners, we save for our golden years so it's just as important for us to ensure ourselves for any unexpected eventualities.

Options to protect ourselves include and not limited to:

- Insurance coverage
- Investment in properties
- Investment in stock markets
- Currency investment
- Other options

Hence, this talk on Affiliation, Acquisition or Mergers!

What is AAM?

To many of us, M&A should take the following prototypes:

- **Affiliation**

  Initial "trial marriage" to matrimonial happiness!
- **Acquisition**

  A complete take-over exercise!

  The alternative is…
- **Merger** – A marriage without try!

Professionalism at the forefront

AFFILIATION, ACQUISITION or MERGER?

The 3 options…

Let's consider these 3 options starting with the respective prototypes from:

1. Strategic "**Affiliation**" option, which for the purpose of this discussion covers both local and global affiliations;

1. A possible **Acquisition** option; and

3. **Merger** as the alternate option.

Affiliation, Acquisition or Merger – Drivers of change!

BUT…

What really are the drivers for an Affiliation, Acquisition and/or Merger?

To me, the main drivers or at least the priorities for an affiliation, acquisition and/or merger are still the following factors:

- **International branding**
- **Clients' retention**
- **Continuity** and/or **succession planning**

Why the need for strategic Affiliation

- ASEAN Free Trade Agreement (AFTA) & WTO
  Trans Pacific Partnership Agreement (TPPA)
  …forthcoming revised Auditors' report!

With AFTA, WTO, TPPA…and more new standards, together with the many arduous challenges coupled with stiff competition that practising firms especially **accounting service providers** are facing; urgent and speedy steps must be taken to strengthen their key intensity…… competitive edge.

Why the need for strategic Affiliation

Among the rationales given are…

- Size
- Extended range of professional services
- Geographical coverage
- Specialisation, and
- Branding – be it local or international

……. All are equally important.

But **THEN…**

How can a firm strengthen its

competitive edge?

Professionalism at the forefront

Why the need for strategic Affiliation

Possible solutions… Strategic Affiliation!

Strategic Affiliation can be either:

- **Local strategic affiliation**, or
- **International strategic affiliation.**

Note:

Strategic Affiliation must be on an **affirmative basis** where all participating members are fully committed to one another!

Benefits of strategic Affiliation

First and foremost, to name a few:

- Geographical coverage
- Branding of bigger "combined" firms
- A platform for specialisation
- Opportunity for capacity and capacity building such as the pooling of resources
- Better clients' retention capability

Benefits of strategic Affiliation

Most importantly…

- **No loss of control of ownership**

The firm will continue as it has been operating before other than being seen as belonging to and/or **forming part** of a bigger group of practising firms.

There is no **risk** of a "divorce" and the huge legal and related **costs** involved especially where there is a break-up, as in a merger.

Selection for business partners

Identifying potential "partner(s)"

Like a courtship, at the start of a relationship..

First, you need to **identify** like-minded practising firm(s) who, ideally share the **similar visions** and **mission** as well as the inherent "**values**", as your own practice firm.

Identify the **form of relationship** (in this case "affiliation-ship") – Be it **formal** or **informal** that the affiliation arrangement would take place.

Selection for business partners

Terms of Agreement

- Payment of an agreed **fixed annual fee** for the affiliation arrangement (be it local or international);

- Payment of **licence fee** for the use of “affiliation name” and “affiliation logo” including the global website among the use of standard quality programmes – To distinguish between annual fee, administrative and operational fee, licence fee etc.;

- Define the **rights and benefits** of the global affiliated membership;

Selection for business partners

Terms of Agreement

- Define the **territorial rights**;
- **Terms and conditions** for the admission of new members to the affiliated global group and region;
- Where possible, clearly spell out the "**Leader**" of the affiliated firms to assume the leadership or management position of the group and/or region;
- **Regional and practice management** to include any financial arrangements;

Professionalism at the forefront

Selection for business partners

Terms of Agreement

- **Marketing** obligations and commitments;
- **Professional liabilities** in line with the By-Laws of each country bearing in mind the professional independence and Anti-Money Laundering Act;
- Members' **obligations** & **restrictions** (if any);
- Agreed upon the **referral** and **introducers' fee** arrangements (if any); and
- **Terms** for the termination of membership to include expulsion of members.

Alternative option - Acquisition

As an alternate option to an Affiliation, consider the option of an **Acquisition** for one firm to buy over another firm

Possible questions raised:

- 😐 Valuation?
- 😐 Fair value?
- 😐 Cost approach?
- 😐 Fee income approach?
- 😐 Market approach?
- 😐 Weighted average?
- 😐 Other formulae?

3rd Option - Merger

As an alternate option to both an Affiliation and Acquisition, is Merger…

From the Editor

What is a MERGER?

A **Merger** is like a marriage!

….A marriage of firms is the process by which two or more firms embark into a business relationship. Essentially, it's the joining of two or more firms in a bond that putatively lasts ...

What are the myths of a ***MERGER?***

Myths – There are many… but let's us look at the common illusions and possibly one nagging thought!

The **illusions** may be…

- Less work
- Shorter hours
- But higher income & better lifestyle!

  (Oops! Wishful thinking!)

The **one nagging thought** is…

- Possible loss of control of your own practice!

True or false? Let's discuss them in the brainstorming session…

A ***MERGER will take care of…***

For a start…

Member firms automatically comply with Part B, *Section 520* of the MIA By-Laws on "Incapacity or death of a **sole practitioner.**"

Surely, a merger would take care of this basic requirement with minimum disruption to the members' practices.

Note:

Likewise, an Affiliation too complies with this requirement.

Why the need for a MERGER?

Like Affiliation, some of the benefits are…

- Opportunity for capacity and capacity building such as the pooling of resources
- Wider scope for the expansion of range of services
- Geographical coverage
- Branding of a bigger firm
- A platform for specialisation
- Greater financial security

Professionalism at the forefront

Why the need for a MERGER?

- Perhaps, most importantly…

Practice continuity

To reinforce what was mentioned earlier…

- The combined merged firm will continue even with the **exit** of a partner or indeed if there is a **change in ownership**;

- Admission of additional partners is made easier since the “partnership structure” is already put in place;

- With a practice continuity in place, clients feel more at ease.

Why the need for a MERGER?

Other significant reasons

- Focus may be placed on practice management and development;
- Better career development and advancement for staff members;
- Better personal development programmes for both staff and management alike;
- Value-added service.

Why the need for a MERGER?

Retirement planning

- An avenue for exit opportunity should the retiring partner wishes to do so without jeopardising the future of the practice;
- Creating a **value** for the retiring partner.

Pitfalls of a MERGER?

Common traps shared among failed merger are:

- **Lack of planning** and the failure to obtain full support and commitment from all participating members;
- **Unsuitable candidates**, the short-sightedness of participating members and personality clashes;
- **Differing** viewpoints, concepts and corporate culture;
- Distorted and **unclear** visions and missions of participating firm's objectives,
- **Valuation of financial asset** worth and possible goodwill of individual firms;

Professionalism at the forefront

Pitfalls of a MERGER?

Common traps shared among failed merger are:

- **Nepotism** and **favouritism**;

"Nepotism" is a polite way of saying "you have no chance in hell of ever being promoted."

- Financial constraints
  – The other extreme angle;
- Non-audit services
  – Failure to expand its range of professional services;
- Autonomy and autocracy;
- Failure to deliver the ultimate "promise" i.e. synergy attainment.
- **Risk mitigation** – Where senior partners are passing most of the risks to the younger partners to avoid practice review or AOB onslaught!

MERGER – The myths, the whys & pitfalls?

Until here…

I have only highlighted the following:

- "**The myths**",
- "**The whys**" and also
- "**The pitfalls**" or "**The traps**" of a merger.

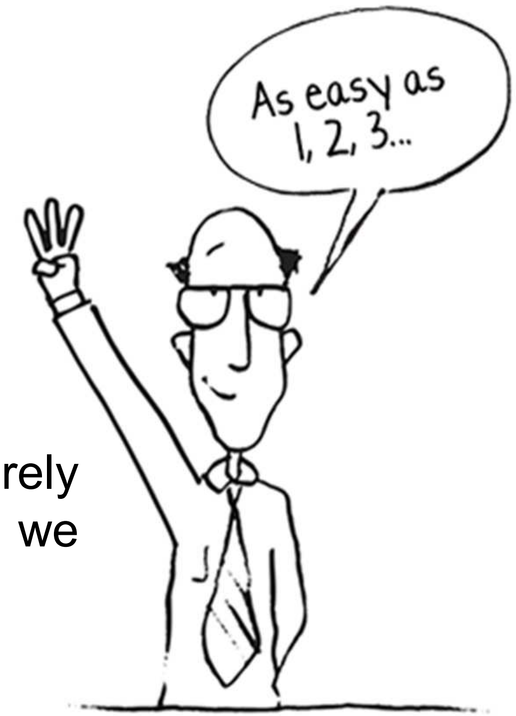
Naturally, a successful merger goes beyond merely understanding these pertinent pointers. Here, we need to understand "The How" factor too!

You need to be mindful of the

Pre-Merger,

During-Merger …and

Post-Merger!



Conclusion…

- It's timely to take stock of where you are now…

Affiliation, Acquisition or Merger (AAM) arrangements are all **viable options** in *moving forward* but you need to weigh out your own personal firm requirements.

All 3 options offer you many advantages although you need to weigh out the consequences in the unfortunate event of a "divorce" or break-up!

Mergers – The legal costs can be exorbitant.

Affiliation – Cost of the membership and related fees.

Note: Once you are in it, BE COMMITTED!

The Global experience……

Ladies & Gentlemen

We shall share experiences during the discussion session!

The power of advertisement

MALAYSIAN INSTITUTE OF ACCOUNTANTS
ACCOUNTANTS. MANAGERS OF VALUE

McMillan Woods

Professionalism at the forefront

The power of advertisement

McMillanWoods 長青
Professionalism at the forefront

"The Business Mind"

MALAYSIAN INSTITUTE OF ACCOUNTANTS

McMillan Woods going beyond borders of business...

Every practising firm or organisation has a role to play, in not only raising awareness of its corporate social responsibility (CSR) initiatives but to walk the talk.

At McMillan Woods, we pledge our continual commitment to CSR drive. On 19 January 2013, **McMillan Woods** planted 201 trees at the Forest Research Institute Malaysia (FRIM) in support of Mother Earth, taking the cue that "Every little step helps to save this planet of ours!", with the theme "McM cares for the environment" – **www.mcmillanwoods.com**

OUR HEARTFELT GRATITUDE AND THANKS
TO THE DEPUTY MINISTER OF FINANCE,
YB SENATOR DATO' IR. DONALD LIM SIANG CHAI
FOR OFFICIATING THE TREE PLANTING CEREMONY.

We would also like to invite interested firms & candidates to share with us the following:

- Like-minded firms to join our fast expanding global network; and
- Suitably qualified professionals and graduates to build their career with us both locally and globally.

McMillan Woods can offer you, your career and your firm access to an unrivalled pool of technical and industry specialists and support wherever you go globally. One of our core values is the Standard of Excellence – the most sought-after attribute that speaks volumes of the breadth and depth of our world-class services.

To take the plunge email us today and find out more at **info@mcmillanwoods.com**

Winners are not people who **never fail**, but people who **never quit**

McMillan Woods

Professionalism at the forefront

Reminder

To practitioners and member firms who are ignorant and still deny to acknowledge these imminent global challenges, they will eventually find their practices unable to withstand the onslaught.

Take the bait or be the bait!

Change or be changed!

ACT NOW...

McMillan Woods

PROFESSIONALISM AT THE FOREFRONT

...one of the fastest growing unique global network!

E305 & E503 & E502 Block E
Phileo Damansara 1, No. 9 Jalan 16/11
Off Jalan Damansara
46350 Petaling Jaya, Selangor Darul Ehsan, Malaysia

Telephone : 603-7665 1738 Facsimile : 603-7665 1739
Email : info@mcmillanwoods.com
Website : www.mcmillanwoods.com
Award website : www.mcmillanwoodsglobalawards.com