Akauntan Nasional

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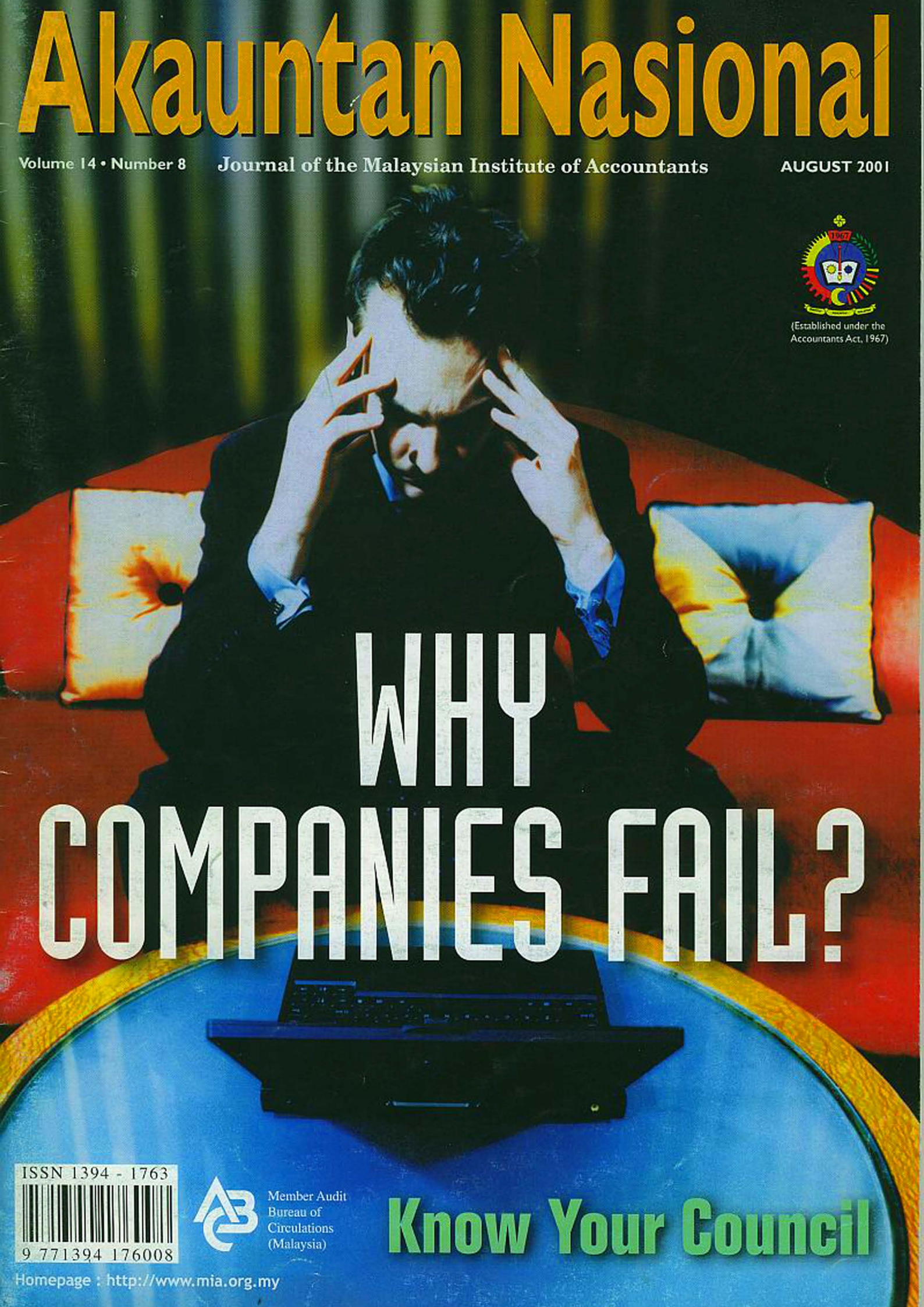

(Established under the Accountants Act, 1967)

WHY COMPANIES FAIL?

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Akauntan Nasional

The *Akauntan Nasional* is the official publication of the Malaysian Institute of Accountants (MIA) and is distributed to all members of the Institute. The views expressed in this journal are not necessarily those of the MIA or its Council. Contributions including letters to the Editor and comments on articles appearing in the journal are welcomed and should be sent to the Editor as addressed below.

Editor, Akauntan Nasional
Dewan Akauntan, 2 Jalan Tun Sambanthan 3, Brickfields, 50470 Kuala Lumpur, Malaysia
Tel : 03-2274 5055, Fax : 03-2274 1783, e-mail : editor@mia.org.my Homepage : http://www.mia.org.my

PUBLISHING CONSULTANT
Executive Mode Sdn Bhd (317453-P)
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Dewan Akauntan
2 Jalan Tun Sambanthan 3, Brickfields
50470 Kuala Lumpur
Tel : 03-2274 5055 Fax : 03-2274 1783, 2273 1016
e-mail : mia@mia.org.my
Homepage : http://www.mia.org.my

FROM THE EDITOR

The Accountancy Profession United!

The wait is finally over. The Institute has a new Council and the President and Vice President have been elected.

Ever since the former MIA Council was dissolved when the amendments to the Accountants Act, 1967, took effect on 28 June 2001, there was concern at the Institute as all major decisions require the Council's approval. Of immediate concern to the staff however was who would sign the next staff pay-cheque, what with the impending nationwide Megasale Carnival in early August?

With 90 per cent of the staff at MIA being female, their contribution towards boosting domestic spending could not be ignored. This crucial factor, among others, would have been taken into account by the Finance Minister when he signed the notification order for the appointment of the new Council soon after. The respective appointees were individually notified by the Accountant-General's (AG's) office in late July and a Council meeting was set for 1 August 2001 with its sole agenda being the election of President and Vice President. At the inaugural meeting held at the AG's office, the 30-member Council unanimously re-elected Abdul Samad Alias and Yue Sau Him, as President and Vice President respectively. The Institute applauds this move as the results display solid unity amongst the individuals in the Council who are major players in the professional accountancy bodies, institutions of higher learning, regulatory bodies, corporate sector, industry and the Government.

The accounting profession can look forward to a bright future as promised by Abdul Samad at the ACCA Open House held later that same day. In his address, he said that the time is ripe to close the chapter on individualism and in its place the various sectors that make up the profession must work towards greater co-operation. ACCA's Head of Malaysia Affairs Nik Roseli Mahmood confirmed that the ACCA had already moved in this direction when he informed the dinner guests that his office had been working extra hard at promoting the MIA's National Accountants Conference 2001, and had in fact secured 200 participants for the Conference from amongst its members.

For those of you who are still thinking about the Conference, you are advised to make your decisions fast. With limited places available, you better be quick if you wish to make a date with us on the 21st and 22nd of this month. Come and listen to the professionals tell you the finer points of "Meeting the Challenges of Globalisation, Liberalisation and Changing Technologies" at the NAC 2001.

Not forgetting, the *Merdeka* month celebrations have begun. This is the time of the year when Malaysians of all races display their patriotic spirit and show their love for the nation. Not through compulsion but voluntarily to commemorate Independence. There are many ways to remember and commemorate *Merdeka*. One is to raise the *Jalur Gemilang*.

Having achieved nationhood for 44 years, we should continue with greater fervour and determination to strive towards building a united Malaysian nation with a sense of common and shared destiny. One of the foremost challenges outlined in Vision 2020 is how to build a united Malaysian nation — "a nation at peace with itself, territorially and ethnically integrated, living in harmony and full and fair partnership, made up of one `Bangsa Malaysia' with loyalty and dedication to the nation". National unity is the key to Malaysia's success. Whether Malaysia will become a fully developed nation by the year 2020 depends on a number of important factors such as leadership and public response. The spirit of patriotism must always be cultivated and nurtured at all levels of society

Happy Birthday Malaysia!

Editor

Letters to the Editor

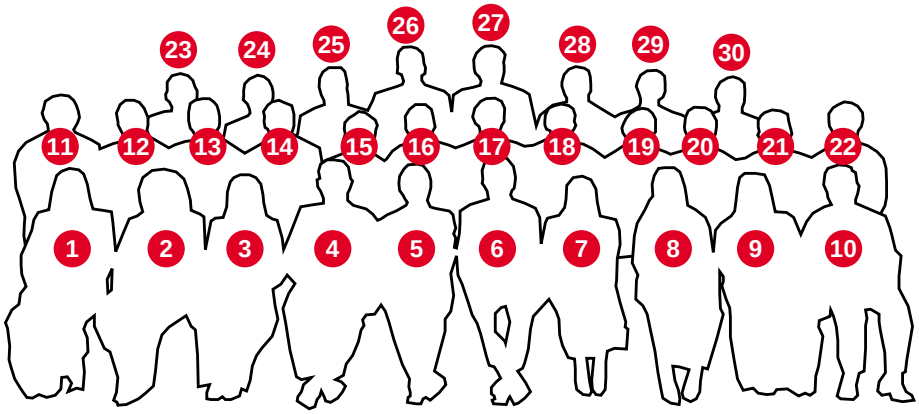
A key element in the world of publishing is what readers have to say. We want to hear from you on just about anything that appears in each issue of *Akauntan Nasional*. Why not drop us a line now?

CONTRIBUTION OF ARTICLES

The *Akauntan Nasional* welcomes original and previously unpublished contributions which are of interest to accountants, executives and scholars. Manuscripts should cover domestic or international accounting developments. Lifestyle articles of interest to accountants are also welcomed.

Manuscripts should be submitted in English or Bahasa Malaysia and range from 2,500 to 5,000 words (double-spaced, typed pages). They should be submitted in hardcopy and diskette (3.5 inch) form in Microsoft Word or Lotus Wordpro. Manuscripts are subject to a review procedure and the Editor reserves the right to make amendments which may be appropriate prior to publication.

MALAYSIAN INSTITUTE OF ACCOUNTANTS' COUNCIL



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19 Dr. Ahmad Faisal Zakaria
20 Yeo Tek Ling
21 Y. Bhg. Dato' Syed Amin Al-Jeffri
22 Seah Cheoh Wah, Tony.
23 Y. Bhg. Dato' Abdul Halim Mohyiddin
24 Sudirman Masduki
25 Md. Nor Ahmad
26 Devanesan Evanson
27 Wong Mun Sum, Albert
28 Mohamad Salleh Mahmud *(Deputy Accountant-General)*
29 Lam Kee Soon
30 Nazlan Ozizi Ibrahim

Not in picture ... Y. Bhg. Dato' Lee Ow Kim, Y.Bhg. Datuk Ali Tan Sri Abdul Kadir.

VISION AND MISSION

The Malaysian Institute of Accountants is the exclusive accountancy body, representing the voice of all accountants in Malaysia and a leading partner in nation-building. The Institute is committed to serving the profession and the nation with integrity and professionalism.

Its mission is :

- To promote and monitor professional standards and integrity.
- To provide education and training to meet the challenge of the ever-changing global economy.
- To conduct and promote research and development for the enhancement of the profession.

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Chairman : Billy Kang

State : **Terengganu**
Location : Kuala Terengganu
Chairman : Su Lim

MIA COUNCIL MEETING

Abdul Samad Haji Alias Elected President of MIA

The Malaysian Institute of Accountants (MIA) is pleased to announce that Abdul Samad Haji Alias was re-elected President of the Council of the Malaysian Institute of Accountants (MIA) at the new Council's first meeting on 1 August 2001. The previous Council was dissolved when the amendments to the Accountants Act, 1967, came into effect on 28 June 2001 paving the way for the Minister of Finance, Datuk Seri Dr Mahathir Mohamad, to give effect to Section 8 of the Act that allows the Minister to appoint up to 30 Council members.

Abdul Samad who was elected onto the previous Council at the Institute's Annual General Meeting (AGM) in September last year, was unanimously re-elected as President by the new Council at the meeting held at the Accountant-General's office. In a show of support and unity among the new members, Yue Sau Him was also unanimously re-elected to hold the Vice-Presidency.

In addition to the Accountant-General of Malaysia, Puan Siti Maslamah Osman, the MIA Council now consists of :

- **Abdul Samad Haji Alias (President)**
- **Yue Sau Him (Vice-President)**
- *Five Council Members appointed from the Higher Educational Institutions specified in Part 1 of the Third Schedule pursuant to section 8(1) (b) of the Act* :

i) **Prof. Dr. Takiah Mohd Iskandar** (Universiti Kebangsaan Malaysia)
ii) **Prof. Madya Dr. S. Susela Devi Selvaraj** (Universiti Malaya)
iii) **Prof. Madya Dr. Nafsiah Mohamed** (Universiti Teknologi Mara)
iv) **Prof. Madya Dr. Noorhayati Mansor** (Universiti Utara Malaysia)
v) **Prof. Madya Dr. Mohamad Ali Abdul Hamid** (Universiti Putra Malaysia)

- *Three Council Members appointed from amongst the Presidents' of the local branches of the recognised bodies specified in Part II of the First Schedule pursuant to section 8 (1) (d) under the act* :

i) **Wong Mun Sum, Albert** (CPA Australia)
ii) **Y. Bhg. Dato' Lee Ow Kim** (CIMA)
iii) **Abdul Rahim Abdul Hamid** (ACCA)

- *A Council Member of the Malaysian Association of Certified Public Accountants* :

i) **Beh Tok Koay**

- *Nine Council Members appointed by the Minister from amongst suitably qualified persons pursuant to section 8(1) (f) of the Act* :

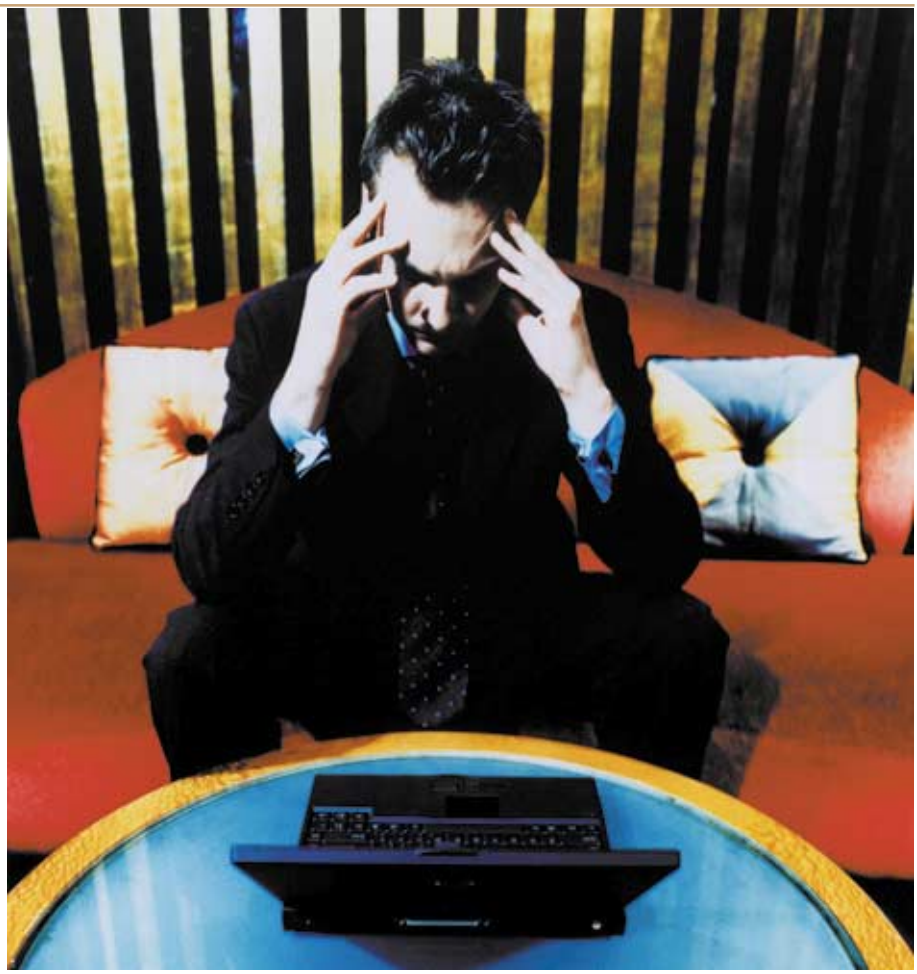
i) **Y. Bhg. Dato' Abdul Halim Mohyiddin** (Partner, KPMG)
ii) **Y. Bhg. Dato' Syed Amin Al-Jeffri** (AlJeffri & Co)
iii) **Md. Nor Ahmad** (Deputy President 1, KLSE)
iv) **Zahrah Abd Wahab Fenner** (Chief Accountant, ROC)
v) **Y.Bhg. Datuk Ali Tan Sri Abdul Kadir** (Chairman, SC)
vi) **Sudirman Masduki** (General Manager, Corporate Services; Amanah Raya Bhd)
vii) **Nazlan Ozizi Ibrahim** (General Manager, Finance; Bank Islam)
viii) **Lee Leok Soon** (ED, MICG)
ix) **Tuan Haji Muztaza Hj. Mohamad** (Managing Director, Fairview Development Sdn Bhd)

- *Ten Council Members appointed by the Honourable Minister of Finance who shall hold office until the first Annual General Meeting of the Institute held after 28 June 2001, whereupon these positions shall be vacated and filled by members of the Institute.*

i) **Y.M. Raja Dato' Seri Abdul Aziz Raja Salim**
ii) **Yue Sau Him**
iii) **Goh Joon Hai**
iv) **Yeo Tek Ling**
v) **Lam Kee Soon**
vi) **Nik Mohd Hasyudeen Yusoff**
vii) **Seah Cheoh Wah, Tony**
viii) **Abdullah A. Rasol** (CEO, Amanah General Insurance Bhd)
ix) **Devanesan Evanson** (President, IIAM)
x) **Dr. Ahmad Faisal Zakaria** (Ahmad Faisal & Associates) AN

WHY COMPANIES FAIL? AN ANALYSIS OF CORPORATE FAILURES

By Shamsher Mohamad, Zulkarnain Muhamad Sori & Mohamad Ali Abdul Hamid
DEPARTMENT OF ACCOUNTING AND FINANCE, FACULTY OF ECONOMICS AND MANAGEMENT
UNIVERSITI PUTRA MALAYSIA



Corporate failures are common in competitive business environments where market discipline ensures the survival of the fittest. The issue of interest is not the incidence of corporate failures but the ability to predict impending failures through some common identifiable attributes. A consistent pattern of changes in these attributes can help formulate and implement pre-emptive measures to avoid such failures. These efforts could reduce the costs of bankruptcy, avoid financial distress to all stakeholders and contribute towards the business and financial environment stability. The documented findings on corporate failures in developed economies provide some general guide on characteristics of firms that fail, however, these findings cannot be generally applied to firm failures in different economic environments, such as, emerging markets due to differences in market structure, provision and implementation of law, and accounting and corporate governance standards.

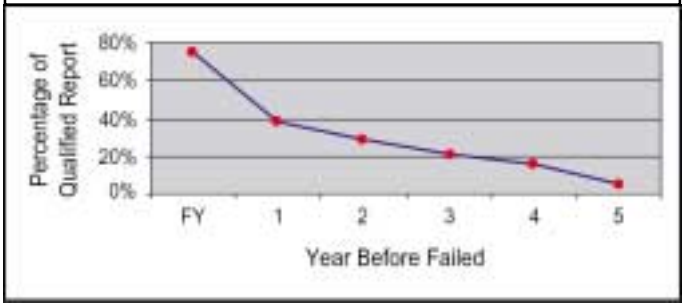
Predicting corporate failure is based on the premise that there are identifiable patterns or symptoms consistent for all failed firms and failure is a gradual process. These symptoms might take the form of declining profits, working capital, liquidity, asset quality, arrears interest and loan repayment, delay in payment to suppliers, staff and other creditors, and implementation of some form of austerity measures. The consistent changes in these common symptoms enable researchers to formulate corporate prediction models in an effort to identify the potential failures and implement corrective measures to avoid and/or minimise the cost of failures in cases where failure is inevitable.

The objective of this paper is to identify the general characteristics of failed firms that were listed on the Kuala Lumpur Stock Exchange (KLSE). The firms were sampled over a period of 19 years, ending 1998. These characteristics could help formulate a more formal failure prediction model for Malaysian firms in the near future. Firms are considered failures when they apply to the court or relevant authorities for a restructuring or reorganisation scheme based on a scheme of arrangement pursuant to Section 176 of the Malaysian Companies Act, 1965. Firms under protection of this provision have to formulate survival options including proposals on strategies for corporate rescues and reconstruction. Highly leveraged corporations with severe financial problems might resort to outright liquidation. However, most distressed public-listed firms usually resort

to restructuring rather than liquidation. The identified general symptoms of failed firms will provide important insights to policy-makers and financial institutions to identify and guide them to formulate effective pre-emptive measures to mitigate potential corporate failures. Sixty-eight listed firms, that sought protection under Section 176 of the Company's Act 1965 and/or approved by the regulatory body to undertake restructuring process of the firms financial condition during the period 1980 to 1998, were sampled and the financial statements of each company was analysed for five years before the failure. The analysis focussed on certain selected attributes (partly based on past documented literature) such as qualified auditor reports, directors' report, type of auditor, auditor changes, size of board of directors and financial ratios analysis. If changes in these attributes follow a consistent pattern over the period of analysis, then the patterns could be used to predict potential failures. The selected attributes of failed firms and the pattern of changes in these attributes are discussed next.

FIGURE 1

Percentage of auditor's qualified report



Qualified Audit Report

One reliable source of information stakeholders use to ascertain the financial health of firms is the audited financial reports, published annually as required by the Company Act, 1965. These reports are prepared by management and audited to ensure that the information reported is true and fair in compliance with the accepted accounting standards.

Information content of audited financial statements is considered as credible and reliable once certified by a qualified auditor. If for some reason the auditor is not fully satisfied on the fairness and reliability of the information reported, the report will be qualified. A qualified financial report is usually associated with some form of problem, and it attracts more attention from users than unqualified reports and usually has a negative effect on the listed firm's value. Since it is not mandatory for auditors to report on the financial health of the firms except to certify the true and fairness of the prepared financial reports, it is expected that failed firms might not have qualified reports even in the year of failure.

Our analysis show that 75 per cent of firms had qualified opinions on their financial statements in the year of failure and 25 per cent had an unqualified report. The firms that had unqualified reports had all applied to be sanctioned under Section 176 of the Companies Act 1965 or approved by the regulatory body to undertake some form of corporate restructuring.

In one year before failure, 62 per cent of the firms had a clean report suggesting no problems of any nature. The percentage of qualified reports remains low from year 2 to year 5 before failure. This is no surprise as the auditors' main focus is to see that the financial statements represent a true and fair view and have complied with the Generally Accepted Accounting Principles (GAAP) practised in the country. The law and the regulatory environment have no provision for auditors to report on the company's financial health and viability. Therefore it is an industry norm for auditors to report the minimum as allowed by the provisions in the law. This is certainly an area that requires attention of the regulatory agencies in the interest of improving the corporate governance standards in the country. If a provision is gazetted in the law for auditors to report on the financial health of the firm at the time when the reports were prepared, this will create the much needed transparency for effective corporate governance.

TABLE 1 General attributes of failed listed firms

	Failure Year	1	2	3	4	5
Qualified Audit Report	75%	38%	28%	22%	16%	5%
Directors' Report	85%	31%	16%	5%	5%	5%
Type of Auditor (Big Six)	53%	53%	49%	46%	43%	41%
Auditor Changes	7%	1%	3%	3%	3%	0%
Size of BOD	6.2	6.0	6.6	6.8	6.5	6.5

Note : 1, 2, 3, 4 and 5 denote one, two, three, four and five years before failure year.

Type of Auditor and Auditor Changes

Fifty-nine percent of the failed firms had non big-six audit firms auditing their accounts five years before failure and this percentage decreased to 47 per cent in the year of failure. In fact, 53 per cent of the unqualified reports in the failed year were issued by big-six audit firms. It is possible that due to the competitive nature of the industry, lack of quantitative indicators to base an opinion, lack of regulatory compulsion to report on a company's health as a going concern, management's ability to negotiate and convince auditors of sustaining a good performance might have led to these results. Furthermore, in the Malaysian context, a lot of public-listed companies are family controlled businesses and are managed by them. It might be that self-interests had taken over institutional interests and auditors had to compromise with these substantial shareholders, even at the expense of minority shareholders. This is another area of interest that can be improved upon for more effective corporate governance. The interests of minority shareholders should not be neglected for the benefit of substantial owners.

There is also an increasing trend towards the choice of big six audit firms near the failure year. Forty-three percent of the failed firms had a reputable auditor five years before failure and the number increased to 53 per cent in one year before failure and in the failure year itself. It is expected that troubled firms would normally engage the serv-

ices of non-big five audit firms in view of the possibility of negotiated compromises with management, which reduces the chances of qualified reports. This could explain the marginal increase in the number of firms engaging the services of reputable audit firms near failure. For those firms that did engage the services of reputable audit firms, near failure could be due to either attempts by these firms to 'clean-up' their act once and for all to improve the quality of reported information and the reporting process or simply a strategy to mitigate negative speculations on the firm and to gain investor confidence. (See Figures 1 & 2)

FIGURE 2 Percentage of big six audit firms

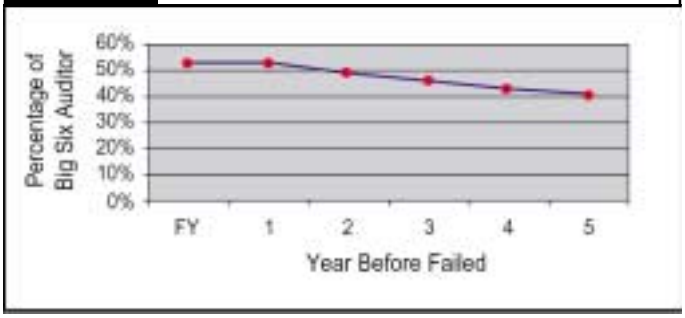
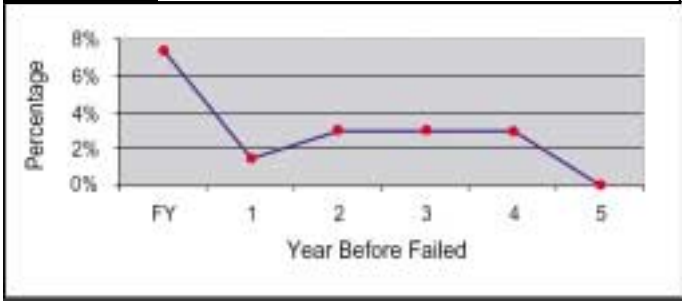


FIGURE 3 Percentage of changes of audits



The Age Factor

Evidence from developed markets (Altman (1983) and Hudson (1987)) suggests that most failed firms are of five years of age or below. This is the start-up age for new firms during which time they either make or break the ranks in a competitive market environment. Findings on the Malaysian listed firms that failed show they were on average between 21 to 30 years old. The minimum age of failed firms is four years and the maximum age is 86 years. A majority of the failed firms were listed on the KLSE for less than 10 years, though the minimum time being listed is three years and the maximum is 38 years. There is no consistent pattern in terms of age and years of listing except that most firms that have failed are, on average, matured firms and had been listed for a considerable time.

Directors' Report

Only 85 per cent of the directors' report of failed firms mentioned about financial ill-health in the year of failure. This implies that 15 per cent of the reports did not indicate any serious problem in the failure year, even though there were negative speculative reports in the mass media. The board of directors have a fiduciary duty to timely convey any pertinent information to the owners of the firm, and failing to do so can be construed as either failing to carry-out their responsibilities as directors and/or misinforming the owners of the true situation. One year before failure, 69 per cent of directors' reports failed to mention about the true situation of the firm. This percentage increased to 84 per cent two years before failure and 95 per cent in years 3, 4 and 5 before failure. These findings suggest that the percentage of directors reports that failed to mention the firms' problems declined significantly from 95 per cent three years before failure to only 15 per cent in the year of failure, a significant improvement in the information content of directors' reports on the true financial health of the firms. This might be due to the greater scrutiny by regulating agencies in ensuring directors not only carry out their assigned responsibilities but are liable for any negligence. This is certainly a progressive step in corporate governance, though there are opportunities for further improvement to achieve a zero-defect objective.

In comparison with the auditors' qualified reports, the directors are more informative about their firms. This is because unlike auditors, the law requires them to promulgate any material information concerning the viability and financial health of their firms.

FIGURE 5 Percentage of directors' report indicating financial problems

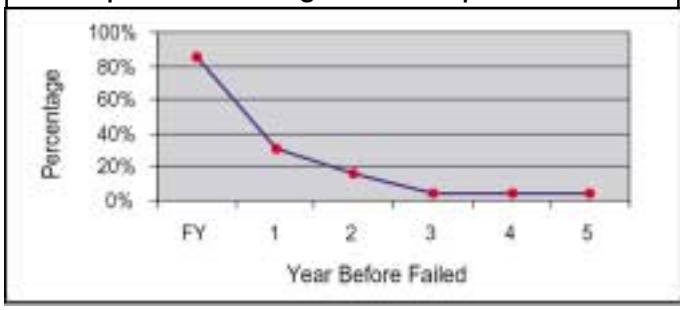
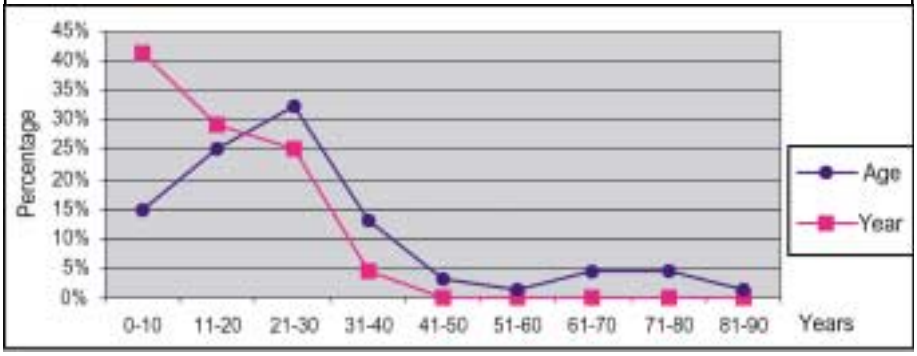


FIGURE 4 Percentage of age and number of years listed of the failed firms



Financial Indicators

The financial performance of the failed firms was evaluated using financial ratios comprising the liquidity, profitability, cash flows and leverage aspects of these firms. Table 2 summarises the average annual values of these financial ratios from five years before to the failure year. Except for the gradual increase in the leverage ratio, all

other ratios showed a gradual deterioration. The most significant deterioration in these ratios occurred one year before failure and in the failure year. In general, such a consistent trend in the changes of these selected financial ratios should provide an early warning on potential failures. These ratios could also be used to develop failure prediction models.

The sudden significant decline in the profitability and cash flow could be attributed to the financial crisis that started in July 1997 and ended in early 1999. The differences in the magnitude of changes in the ratios between the year of failure and one year before failure compared to the other three years do imply some complacency in timely and fairly reporting the true situation.

Conclusion

Some important attributes of failed listed firms were analysed in an effort to identify patterns in these attributes that could be used as possible benchmarks for identification of potential failures. These attributes were the age of the firm, the auditors' reports, the directors' reports, the trend in selected financial ratios to ascertain the profitability, cash flow, liquidity and leverage performance of firms for five years leading to the failure. There were no patterns observed in the age factor as the average age of failed firms is between 21-30 years and firms on average failed before 10 years of listing. However, there was evidence of gradual deterioration of profitability, cash flows, liquidity and leverage level of the firms five years before failure. This deterioration was even more significant one year before failure and in the year of failure.

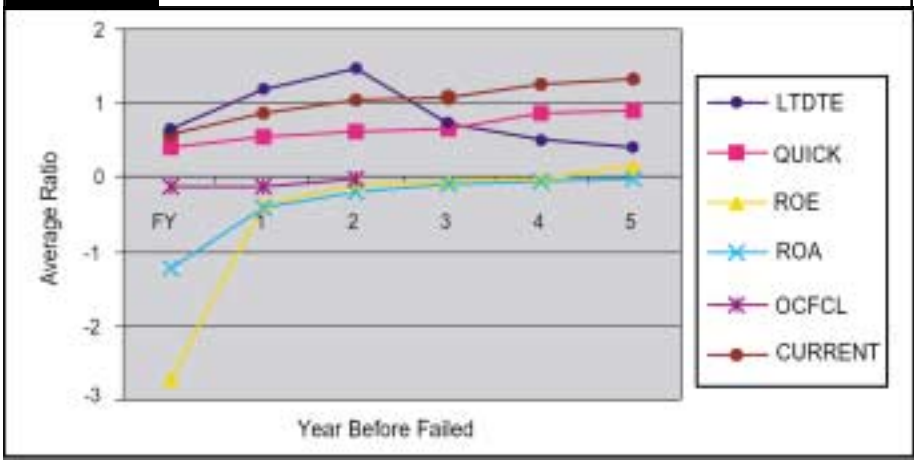
Overall, the findings did indicate that the directors' reports were informative about the firms' financial health, though there is still room for improvement. Evidence of unqualified audit reports for a small part of the sample even in the year of failure suggests that although auditors are not legally required to report on the financial health of firms, the law could be improved to include this provision in the interest of more effective corporate governance.

The findings suggest no clear patterns for identification of failures, except for the trends in financial ratios. The next stage of research will use these ratios in constructing failure prediction models for Malaysian listed firms. AN

TABLE 2 Average Values of Financial Ratios of Failed Firms from 5 Years before Failure

	Failure Year	1	2	3	4	5
Current Ratio (CURRENT)	0.593203	0.869393	1.051801	1.071984	1.259571	1.329533
Quick Ratio (QUICK)	0.41851	0.533724	0.618618	0.653657	0.860334	0.893657
Return on Equity (ROE)	–2.69892	– 0.37196	– 0.10575	– 0.06281	– 0.00467	0.166145
Return on Assets (ROA)	–1.22576	– 0.40231	– 0.18416	– 0.10906	– 0.0476	– 0.00567
Operating Cash Flow to Current Liabilities (OCFCL)	– 0.11632	– 0.12304	-0.02109	NA	NA	NA
Operating Cash Flow to Total Liabilities (OCFTL)	– 0.22132	– 0.09823	– 0.01988	NA	NA	NA
Long Term Debt to Total Equity (LTDTE)	0.641956	1.199351	1.455369	0.730277	0.522304	0.402249

FIGURE 6 Financial ratios of failed firms



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OUTSOURCING OF INTERNAL AUDITING SERVICES

By Kenneth Lim Sze Juan
HELP INSTITUTE, KUALA LUMPUR

This article first brings the readers through a brief historical background on how outsourcing of internal auditing services came about. It then discusses the motivation behind its demand. The negative implications outsourcing has over external auditors, internal auditors and the management are presented. Finally, solutions are offered and the reasons why internal auditors and external auditors are racing against time and against each other are given.

If you think that the major function of accounting firms today is to provide traditional accounting and auditing services, think again. The current business environment dictates otherwise after almost a century of traditional auditing practice. As of year 2000, non-auditing services constitute more than two-thirds of total revenues for these firms with one of the big five accounting firms confirming that such services have constituted a staggering 80 per cent of its total business before that year. (B. K. Sidhu, 12 October1999, Arthur Anderson posts 27 per cent growth, Business, *The Star*, p.3)

Many of these firms are zealous enough to dispel public perception of them as being only audit service providers and believe that aggressive venturing into other professional services is the only way forward in the accounting industry. Such services include investment banking and other capital raising activities, various types of strategic planning and operational consulting services, assistance in finding business partners, finding acquisition candidates, gaining regulatory approval for major transactions, management services, direct foreign investments, joint ventures, privatisations, equity restructurings and the list could go on.

Of all these services, non-other has received the most publicity and attention than contracting of internal auditing services. Commonly known as outsourcing of internal auditing services, it is defined as an arrangement where an organisation's internal auditing function is performed by its external auditors on a contract or 'extended audit services' basis (Available online : http://www.theiia.org/profissu/48-92695.html). Although the type of service offered is clear, there is still an invisible thin white line separating the extent and amount of involvement in the service the auditor should or should not engage in, that could impair his or her independence. This is worrisome as it results in the line being frequently crossed. Before we go further into this issue of independence, let us first understand the motivation behind the offering of such services.

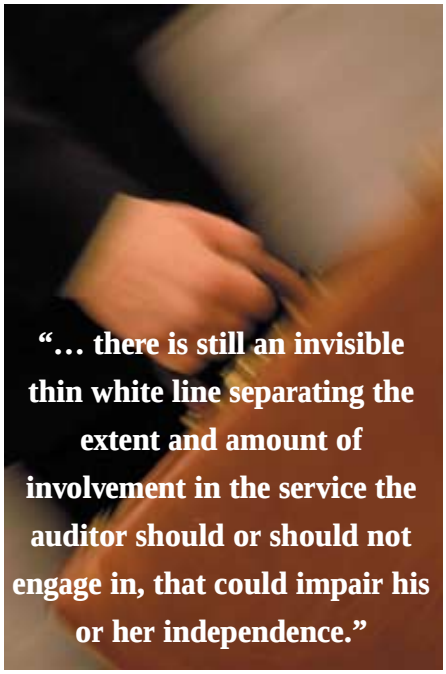
In 1996, 21.5 per cent of organisations in the US contracted some internal audit work and 32.4 per cent is expected to do so in the future making it more than 50 per cent of companies in that country relying on internal audit services provided by external auditors. Similarly in Canada almost 70 per cent of organisations there were expected to do so in the years after 1996. ([Online] Available : http://www.theiia.org/edprods/kusel.html). What makes such services so attractive to these organisations including those who already have internal auditors being employed?

The outsourcing of such services is motivated primarily by three factors namely the economic factor, size factor and the efficiency factors.Outsourcing permits organisations to cut costs by taking advantage of internal auditing services only as and when they are needed rather than maintaining one in the organisation even at times when their services are unwanted. ([Online] Available : http://www.theiia.org/pamflets/pers_outs.html). Thus the organisation only pays for the time the contractor is engaged and this helps save a lot in operational costs.

Besides that, organisations need not worry about other related costs and issues such as training costs, sick time, travel costs, maternity leave and holiday pay as all these are incurred by outsourcing service providers.

Furthermore, outsourcing service providers suggest that they are able to help organisations around the world reduce double work in training activities as they are able to achieve economies of scale in doing the same thing and therefore allow these organisations to obtain the outsource services from them at a fraction of the total cost that would have been incurred by them had they done otherwise.

When it comes to factors motivated by size, managers believe that small firms do not warrant the need to maintain costly internal auditing departments as the cost outweighs the benefits of doing so. They could easily contract the service out and forget about the issue once and for all.



In addition, for firms that do have internal audit staff but are relatively small, they may obtain additional internal audit services in areas where they are not competent enough through such outsourcing.

Finally, organisations demand such services due to the efficiencies they contribute to their firms. Outsourcing allows the management to focus more on core competencies as it frees the management to concentrate on pursuing more strategic objectives rather than on daily operations that do not significantly contribute to their firm's growth. ([Online] Available : http://www.theiia.org/pamflets/pers_outs.html)

Besides that, whenever managers feel that they have to make sensitive decisions that are too awkward to be done by themselves, obtaining an unbiased, third party opinion can actually save the management from the dread of going through such procedures.

It is also argued that external providers have more experience and exposure to different operations of similar or different organisations and thus would be more contributive in their advice or guidance. Their access to various strategies of different firms would thus be a good indirect source of 'best practices' information for those managers. ([Online] Available : http://www.theiia.org/pamflets/pers_outs.html).

Lastly, managers contend that since external providers are able to achieve economies of scale in training activities, more value added knowledge can be taught by these external providers than the managers would have done by themselves thereby increasing their expertise dramatically. It is this extraordinary expertise that the management is looking for when outsourcing internal auditing services.

While the future seems bright to accounting firms around the world, it could be downright detrimental to the integrity of their profession as it seems that all these future hopes would have to live on their betrayal towards their own independence. The function of an external auditor has always been to provide an independent opinion as to the truth and fairness of their client's assertions and such independence forms the structural backbone on which the profession depends for its survival and going concerns.

Providing internal auditing outsourcing services is believed to impair the external auditors' independence, as they would end up attesting to the management's assertions to which they have significantly been involved in drafting. How is this so?

Internal auditors provide supporting assurances that permit the management to make public assertions as to the effectiveness of its internal control structure. The external auditors role here is to attest to those assertions for truth and fairness. However, when the same external auditors perform all the internal auditing activities, that is by providing supporting assurances to the management, they would later be attesting as external auditors to the management's assertions which was prepared by the supporting opinion provided by the external auditors themselves.

Thus those auditors would not be independent, as they have in effect attested to their own opinion by becoming an indirect advocate of the management's assertion. ([Online] Available: http://www.theiia.org/profissu/48-92695.html). They have also rendered themselves incapable of providing a second fresh opinion on those assertions as they have lost their independence.

Besides that, the professional accounting bodies have various opinions on this issue. It is stated in the Institute of Internal Auditors (IIA) Standards for Professional Practice of Internal Auditing (standards) that "the internal auditing department is an integral part of the organisation and functions under the policies established by senior management and the board". ([Online] Available: http://www.theiia.org/profissu/48-92695.html). For the American Institute of Certified Public Accountants (AICPA), they have produced interpretation No. 97 under Rule No. 101 of the AICPA Code of Professional Conduct, which consistent with the COSO Report, states that "when an external auditor performs the internal auditing function, the auditor becomes part of the internal control system because internal 'monitoring' is a management's function and independence would therefore be impaired". ([Online] Available: http://www.theiia.org/profissu/48-92695.html).

Therefore, an organisation cannot delegate its total responsibility of monitoring the effectiveness and efficiency of its control structure to an external party and external auditors cannot hope to salvage their independence if they ever set foot on an organisation's internal auditing function.

What about internal auditors? Has anyone considered their case and concerns about the whole issue? After all, they are the most important stakeholders in this outsourcing issue, as they would tend to lose the most if such outsourcing prevails into all industries in the future.

The IIA has already recognised the threats this issue imposes on the profession. It also acknowledges that it is true in some cases where third party providers are often experienced and skilled internal auditors, CIAs, partnerships of GAIN and supporters of IIA programs which managers would rather turn to, for improved quality in auditing services. ([Online] Available: http://www.theiia.org/edprods/kusel.html).

Considering such prevailing circumstances in the business environment, the Institute has had to fold up its sleeves and put some plans into action to save the profession from being eaten up by obsolescence. One of which is to capture and control the entire profession of internal auditing particularly external auditors performing internal auditing functions. Members would then have to comply with the rules imposed by the profession thus allowing it to dictate the do's and don'ts of the external auditors' actions in the hope of safeguarding the profession as a whole from the emergence of a new branch of internal auditors.

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In response to this, external auditors have expressed their willingness to comply with the rules of IIA but will not accept its leadership role. ([Online] Available: http.//www.theiia.org/isunaswr/l3.html). This means that they will comply with the rules imposed by the Institute but will not hesitate to make any changes in their practices if the need arises regardless of whether the Institute approves of it or not.

On the other hand, members of the Institute with more than 52,000 internal auditing professionals located in over 100 countries worldwide still think that more work could still be done to save the profession from being taken over by certain so called 'more cost effective and experienced' external providers.

Many have accused the professional body of not actively selling the quality of their services to the management resulting in many organisations perceiving the services provided by accounting firms to be more superior in quality.

One director of a large bank in Illinois complained that if both CPA and CISA designations have successfully won the acceptance and recognition of managers, why couldn't the CIA designation do the same. ([Online] Available: http://www.theiia.org/edprods/kusel.html). Another similar director claimed that it is all a matter of simply promoting the profession, as many external providers were formally internal auditors who have lost their jobs due to outsourcing. "It is thus not the skills of the individuals that are lacking but merely an illusion of dollar savings and real value added from consulting services" ([Online] Available: http://www.theiia.org/edprods/kusel.html).

While the Institute is toiling away to salvage whatever that is left of the profession, the outsourcing has finally taken its toll with more and more internal auditors losing their importance and even their jobs especially through downsizing exercises.

Before we go further, the management must also be reminded that there are negative implications installed for them too for pursuing such outsourcing services. They may have to contend with higher premium demands by external providers as the external providers gain more institutional knowledge about the organisation over time more than anybody else can. ([Online] Available: http://www.theiia.org/pamflets/pers_outs.html).

Besides that, it is argued that an external provider wouldn't know the organisation's business in and out as well as the internal auditor who has already developed a unique and broad perspective of the organisation including its corporate culture. ([Online] Available: http://www.theiia.org/pamflets/pers_outs.html).

Managers are also warned that there may be no continuity in inheritance of special management skills specific to a unique firm which could only be acquired through continuous exposure by internal auditors to significant strategic decisions, controls and operations of the firm. This means that a firm may be successful today because of a capable manager it has, but no longer in the future when that manager retires.

But that's not all, a control environment which exists when internal and external auditors act as check and balance against each other would be diminished if the external auditors and internal auditors are one.

Whether these costs outweigh the be-

nefits addressed earlier on remains a judgment left to be decided only by the managers who understand their organisations better than any one else can. The same may not be true for external auditors however as they still have a duty to uphold independence even if the benefits outweigh the costs.

With so many problems emerging, one cannot help but expect to see generous outpouring of solutions to mend the issue. After all, the outsourcing industry helps external providers rake in billions of dollars in revenue every year and they would not like to see the rainbow to their pot of gold being undermined.

The first of these solutions involves performing one time services under the supervision of the internal auditing director in areas that do not represent a material portion of the total internal audit functions. It is believed that such monitored one time events would not be significant enough to affect auditors' independence as compared to becoming an integrated part of the clients' control systems. ([Online] Available : http://www.theiia.org/proffisu/48-92695 .html).

Besides that, the type of services meant under 'extended audit services' should be clearly listed down so that activities that would impair an external auditor's independence could be identified and avoided.

In different situations where attestations are required, the external auditors could obtain assurances from their clients that they did not rely heavily on their advice and recommendation when formulating management assertions. ([Online] Available : http.//www.theiia.org/proffisu/50-11596.html). An example is FDICIA situations.

Next, it is argued that the internal auditing services could be obtained from external providers who are not the firm's external auditors as a means of preserving total independence altogether. Of all solutions provided this seems to be the most effective one in circumventing the prevailing independence problem. It is observed that the total market for such outsourcing services would not be diminished as each market participant would still retain his initial portion of share in the industry but only this time, of a different pie as it would be a different client. ([Online] Available : http://www.sec.gov/news.speeches/spch114.txt).

This has been practised by all Norwegian commercial and savings banks and insurance companies beginning February 9, 1995 as instituted by their Securities Commission. ([Online] Available : http://www.theiia.org/profissu/48-92695.html).

Apart from that, the IIA proposes that although internal audit services are outsourced, the management function of the work must be maintained by the client's employees. This would involve clearly spelling out the responsibilities the management and the external auditors would individually assume so that cross performance of each other's functions could easily be identified as an impairment of independence.

That is not all. A report established in the US suggested a total revamp of the traditional auditor-client relationship so that external auditors are now accountable to the board of directors as representatives of shareholders, rather than to the managers as it has always been. ([Online] Available: http://www.sec.gov/news.speeches/spch114.txt)

This would definitely secure some investor's confidence that the external auditor's independence is preserved as it is free from management's pressures.

Finally, many accounting firms have practised 'walling off' audit and attest function departments in the hope of garnering public confidence that the attesting personnel of the firm is not performing internal auditing services and thus would be able to give an unimpaired, independent fresh look of their client's assertions.

In conclusion, everyone in this prevailing issue from internal auditors right up to external auditors have a role to play as their survival is at stake. It can no longer be denied that independence is already being impaired judging from the disapproving response external auditors are receiving from investors. But on the bright side, their massive contribution to industries around the world through management consulting services has succeeded in spurring economic growth, increasing a nation's per capita income, creating new jobs and even jump starting dead economies. Of course the public would not be bought over and are still keeping mum for the time being but this won't last for long. While the issue has yet to become full blown, accounting firms have every opportunity to devise ways in convincing the public of its independence. If this issue is not addressed, it would undermine and compromise the profession's reputation for objectivity and independence and society may revoke the huge benefits of respect, esteem and the right of self-regulation it has awarded to the profession. Internal auditors have no rest either. Before the external auditors succeed in convincing investors of their independence, they would have to promote and market the superiority of their profession as soon as possible.

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All said, it is like an ongoing cycle looking for a solution where internal auditors cannot be completely eliminated as external auditors have yet to solve their independence issue. But external auditors would not stop supplying internal auditing services as they are still demanded by managers around the world. Both internal and external auditors are still trying to convince managers and investors respectively of their individual superiority and independence and it's all a matter of perception. Ever wondered why the issue remains unresolved until today? AN

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INVESTMENT IN MAN OR MACHINE?

A Break-even Situation

By Dr. Sukdeo S. Gunjal & Lee Seng Fatt
SENIOR LECTURERS, DEPARTMENT OF ACCOUNTING AND FINANCE, UNITEN

Since globalisation has become the focus of the business community, all economic sectors in the region have taken a wide range of strategic measures to greet the arrival of this new era, with the objective of either staying competitive or gaining advantage of the borderless markets. The Malaysian Prime Minister, in his speech while unveiling the Eighth Malaysia Plan, has set the pace for the nation to develop into a knowledge-based economy by building a strong human resource base. He also pointed out that during the seventh plan period, efforts were made to increase the capital-intensity of the production processes through encouraging firms to adopt more labour-saving technologies. Increases in productivity and competitiveness could be main key strategies to enable the nation to face the challenges of globalisation and sustain economic growth.

Regardless of which economic sector the business entity is operating in currently, one way to enhance value-added in products is through mechanisation of production processes with updated labour saving technologies. The replacement of mundane labour operation by new machines or equipment is inevitable in supporting the implementation of productivity-driven growth. As such, it is envisaged that firms will be stepping up their production capacity by investing in more efficient machines instead of relying on the traditional manual processing.

Man or Machine Decision

The management accountant is concerned with providing information (both financial and operating) to those responsible for managing the business and help them in making decisions about future plans. He or she is also actively involved in helping management in the process of planning, controlling and implementation of decision-making. The management accountant constantly keeps himself updated about new accounting techniques and models successfully implemented elsewhere in the industry. Data is collected and compiled for the purpose of evaluating these techniques and models for achieving the objective identified. In the implementation stage, the actual outcome is compared with the estimates and variations from the plan, which have to be dealt with accordingly.

The model discussed in the following paragraphs describes as to how much one can invest in a machine if one man is saved. The model is based on the concept of break-even operating costs of a machine or labour. Most capital investment decisions once implemented are irreversible. Furthermore, a large proportion of the firm's resources is usually committed to that particular purpose. As such, capital investment decisions are guided by a carefully designed model that incorporates the criterion and constraints of the alternatives.

Criterion for Decision-making

For determining the optimum course of action, the outcome of each alternative needs to be predicted by attaching values to the variables. In this process, cost minimisation would form the fundamental objective consistent with the Economic Theory. As timing of cash flows is the means of ensuring corporate survival and the increase of shareholders' wealth, minimisation of the net present value (NPV) of future cash flows would be a suitable operational surrogate for mere cost minimisation, on the assumption that sales levels remains unchanged. Furthermore, the NPV takes into account all cash flows over the life of the project and makes allowance for the time value of money.

The Analytical Framework

For the purpose of building the decision model, only specific cash flows associated with the investment project are relevant. If a cost is the same regardless of the alternatives selected, such cost is ignored in the analytical framework. For instance, *sunk cost* that has been incurred and cannot be avoided is excluded from making investment decisions. *Depreciation*, which is the allocation of the depreciable value of an asset over its estimated useful life, will not be relevant since it is not a current or future cash outflow. *Committed fixed costs* such as rental of existing premises and salaries of management personnel are also excluded.

Direct labour costs, *indirect labour costs* and *labour fringe benefits*, so long as they are incremental specifically to the alternative, are taken into consideration. *Labour fringe benefits* such as costs of insurance programs, retirement plans and hospitalisation plans, workers compensation, etc. are not to be left out.

Opportunity cost which measures the potential benefit given up when the choice of one action precludes selection of an alternative action is relevant and should be included in the discounted cash flows calculation.

Benefits from automation are included where possible. Such benefits can generally be categorised into tangible and intangible. Tangible benefits may be in the form of decreased labour costs, reduction in defective output which in turn results in fewer inspections, less waste and warranty work. On the other hand, intangible benefits may result from greater speed, consistency, reliability and flexibility that enhance product quality. With the speediness in responding to customer demand, a company may afford to reduce its inventory level. Tangible benefits are generally easier to identify and measure than intangible benefits.

The cost of capital used for discounting purposes should be fair and realistic. As a guide, the average rate of return the company needs to pay to its long-term creditors and shareholders for the use of their funds may be used as the discount rate. Alternatively, a number generally accepted by the industry may be used. In theory, the required rate of return on a project of average risk should be at least as high as the organisation's cost of capital (MP2).

Problems in Benefit Estimation

Several benefits may follow from the replacement of labour by machine. Such benefits include lower inventory levels resulting in saving on working capital investment; less floor and storage space and improved product quality. It is argued that these benefits do extend beyond the immediate period of the expenditure and they are difficult to be incorporated in a discounted cash flow calculation. Excluding these benefits from an NPV analysis may mean that they are being valued at zero. Notwithstanding the difficulty involved, it would still be preferable to make some estimates of these benefits to the best one can possibly do than to ignore them.

Man Versus Machine Model

Background : The decision as to how much capital can be invested if one man is saved depends on the operating costs involved in each alternative. Past experience shows that the break-even point of the operating costs of man or machine widely differs from company to company. However, the accountants have developed appropriate figures based on past experience and cost data of operations relating to their individual activities.

The basic concept underlying the model is that one has to find out the cost of operating a machine or the cost of keeping a man over a specific period of time. Once these costs are available with reasonable accuracy, one can equate the operating cost of man and machine with the capital investment involved. Basically, the model assumes that the operating costs vary with the usage of services of man or machine. It is true that major operating costs associated with machines vary with elapsed time in usage of capital investment and the operating costs of labour vary with the amount of labour and elapsed time. It is, therefore, easy to find out how much capital investment can be made if one man is saved.

TABLE 1 Average Annual Cost Per Labourer

Year	Annual Wages RM	Perks Total RM	DCF RM	@15%	NPV Amount RM
1	7,200	4,800	12,000	0.8696	10,435
2	7,560	5,040	12,600	0.7561	9,527
3	7,938	5,292	13,230	0.6575	8,699
4	8,335	5,557	13,892	0.5718	7,943
5	10,002	6,668	16,670	0.4972	8,288
6	10,502	7,001	17,503	0.4323	7,567
7	11,027	7,351	18,378	0.3759	6,909
8	11,578	7,719	19,297	0.3269	6,308
9	13,894	9,263	23,157	0.2843	6,583
10	14,589	9,726	24,315	0.2472	6,010
11	15,318	10,212	25,530	0.2149	5,488
12	16,084	10,723	26,807	0.1869	5,010
Outflows	134,027	89,352	223,379		88,767
Average Net Present Value per Year					**7,397**

Operating costs : The annual operating costs associated with machines are estimated wear and tear, and interest on borrowing and maintenance. In regards to labour, major costs involved are wages and benefits. The labour also get promotion and grade changes during specific periods as per employment policies. In order to compare the operating costs of machines and man, one has to assume that the labour remains with the company till the machine lives its useful economic life. For illustrating the model it is presumed that a machine has 12 years useful economic life.

Annual Cost of Man : For simplicity, it is presumed that a labourer is paid basic minimum wages of RM600 per month. The benefits such as SOCSO, EPF, medical, housing, etc. may cost another RM400 per month. Thus, a worker's total earnings for a year will be RM12,000. Further it is assumed that the worker gets a five per cent increase in basic wage (which indirectly entitles the worker to get higher benefits also) and after every four years, there is a grade change which increases the wages by approximately 20 per cent. Thus, every year, wages and benefits will increase by five per cent of the previous year's earning. However, at the beginning of year five and nine these will increase by 20 per cent. Since the outflow of wages takes place over the future 12 year period, it is necessary to discount the same at an appropriate rate of say, 15 per cent per annum. With these assumptions, present cost of a labourer over the next 12 years is shown in Table 1.

Estimated Annual Operating Cost of Machines :

a) *Depreciation* : A machine or equipment will have a useful economic life of 12 years. Annual depreciation, considering four per cent scrap value and straight-line method of charging, will be eight per cent of the capital cost, i.e. (100 – 4) / 12.

b) *Maintenance* : The annual maintenance costs will grow with the age of the equipment. However, it is possible to find out an average maintenance cost of existing equipment and relate the same to the capital cost. Past experience shows that the average annual maintenance cost during the life of the equipment will be approximately equal to its cost of annual depreciation. This is a rough estimate and will vary from industry to industry. For the purpose of this model, we assume that annual maintenance cost will be eight per cent of the capital cost.

c) *Interest* : It is assumed that the amount of investment in the equipment is borrowed from a financial institution. The terms are re-payment in 10 half yearly equal instalments with annual interest at say 13 per cent on a diminishing balance. This means, the loan and interest thereon will be repaid during the first five years of the assets life. The amount of total interest payable in five years will be equally divided over the life of the equipment. At 10 per cent annual rate of interest, RM 100 will carry interest of RM27.50 during five years and if this amount is spread over the economic life of the asset, the average annual interest cost will be RM2.29. (Refer Appendix). For this model, we presume that the annual interest rate is 13 per cent which means the total interest over five years will be approximately RM36 or over the life of the asset it will come to three per cent per annum on the capital investment. In summary, the total annual operating cost of an equipment, considering major elements will be 8% + 8% + 3% = 19%.

Equivalent Investment : The amount of investment in a machine that replaces one labourer can now be worked out. If the investment is assumed to be RM X, the 19 per cent of X should be equal to the amount annual labour cost of RM7,397. Thus X = (RM7,397/0.19) or RM38,932. This indicates that if one invests RM38,932 in a machine, the annual operating costs of this machine will be 19 per cent of capital investment, i.e. RM7,397, which is equal to annual cost of a labourer. *In a situation where 10 workers are working in a shop and by automation 8 of them can be saved, the value of investment to break even will be 8 x RM38,932 or RM311,456.*

Use of the Model : The main purpose of the above model is to quickly estimate as to how much one can invest in a machine if certain number of workers is saved. The model can be used as a "Rule of Thumb". This "Rule" may become useful when a general manager of a factory visits a trade fair and sees a machine that can save certain number of workers. If he or she knows the labour saving potential of their company, he or she can quickly estimate as to whether purchase of the machine will be economical or otherwise.

Other associated costs : Nevertheless, the other associated costs of machine or man will need consideration only when they are significant. For example, the machine may require high power cost, costly tools, dyes, jigs, fixtures, gauges, specific consumables, etc. which are not required in a manual process. However, the other benefits such as

speed, accuracy, less supervision and low job rejection rate on the machine may outweigh these additional costs. While certain consumables, hand tools, space, power, etc. are also common whether one uses machine or labour, one has to carefully emphasise on the additional cost elements if they are playing an important role while going for automation. Tax benefits are not considered in the calculations since the machine is usually entitled to capital allowance while labour costs are tax deductible.

Sensitivity Analysis

Reliable estimates and forecasts are vital to capital investment decision. Risks do arise from the uncertainty about the future cash flows. Error in estimation is hard to avoid in view of the complexity of the machinery and the firm's inexperience with the new technology. One way to study the amount of risks involved is to conduct a sensitivity analysis on the key variables. Sensitivity analysis sheds light on the amount by which a key variable can be varied before the project fails to meet the decision criterion, all other things being held constant. Every company can develop its own parameters of interest rate, rate of return, depreciation, maintenance, labour costs and other relevant cost elements. A small change in any one or more of these elements may have a bearing on borderline cases of investment decisions. For practical application of the model described above, companies can develop their own estimates of an average labour cost per annum and estimate the extent of investment in automation possible through labour saving potential.

Cautions on Staff Appraisal

In an organisation where responsibility accounting prevails, due care should be placed on the recommendation put forward by the divisional manager. The divisional manager can be bias and take his self-interest into consideration depending on how he is being appraised for his performance. If he is held accountable for the profit of his investment centre, he might propose to adopt an alternative which minimises cost in accounting terms though the project recommended does not result in the lowest net present value of cash outflows. The impact on him can be more severe if his incentive or bonus is linked to the accounting profit of his division. A manager who has no intention to serve long in the organisation is more motivated to make a proposal that shows better short-term accounting return despite having an adverse impact on the firm's long term value. Hence, there is no goal congruence between the organisation and its staff force.

The above problem arises because of the difference between the criterion used for decision-making and the measure used for evaluation. One way to overcome this problem is to evaluate managers based on actual cash flows compared with those originally budgeted (Emmanuel and Otley, 1976) instead of using the accounting return basis.

Furthermore, it is common that managers involved in the proposal to acquire a substantial piece of asset are given a range of personal benefits following the acceptance. As such, stringent capital investment appraisal procedures should be formulated for implementation and decision making is to be reserved to the very highest levels of management.

Post-audit of Investment Projects

A post audit should be carried out to see whether expected results are actually realised. The post completion review of project decisions is one of the components of the management practice of systematically monitoring and providing feedback on the performance of past actions in planning or implementation (MP6). It provides an opportunity to review not only the current cash flows of a project at the date of review, but also to review the updated future cash flows of that project. The actual observed data is used in the analysis. Managers who are responsible for the original estimate should be requested to explain any major differences between estimated and actual results. Post-completion audits are conducted for the main aim of learning rather than for control purposes. Such review should not be used to criticise those involved in making the forecasts but more for improving future forecasts.

Conclusion

In order to enhance the country's international competitiveness so as to catch up with the developed nations, it is crucial to increase the total productivity of the existing resources. Increasing the knowledge content of all economic activities and the churning of a new breed of highly skilled and knowledge manpower are desired in the new decade to cope with the swift technology changes. Firms that hold back and do not automate will be eventually lagging behind for failing to provide a competitive advantage using new technology. However, investment decisions must not be unplanned and uncontrolled in order to gain its maximum potential benefits. A management accountant has a significant role to play as he is entrusted with the responsibility of the use and accountability of organisation resources. For preliminary considerations in investment decisions, the above model will be very useful. AN

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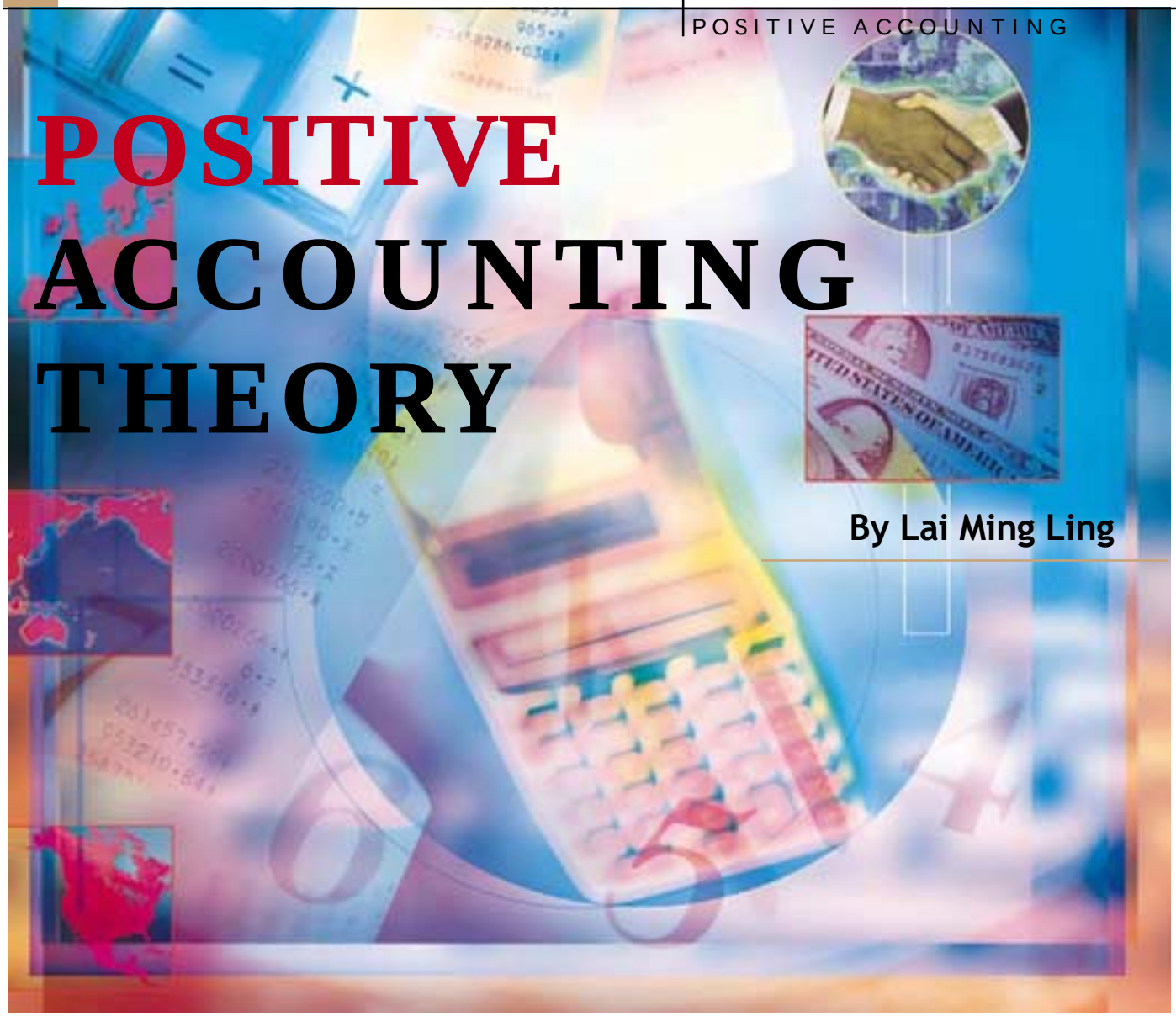
APPENDIX

Table showing interest calculation for a loan of RM100

Year End	Amount Balance	Interest @ 10%	Interest @ 13%
0.0	100	0.00	0.00
0.5	90	5.00	6.50
1.0	80	4.50	5.85
1.5	70	4.00	5.20
2.0	60	3.50	4.55
2.5	50	3.00	3.90
3.0	40	2.50	3.25
3.5	30	2.00	2.60
4.0	20	1.50	1.95
4.5	10	1.00	1.30
5.0	0	0.50	0.65
Total Interest for 5 Years		27.50	35.75
Average over 12 Years (%)		**2.29**	**2.98**



POSITIVE ACCOUNTING THEORY

By Lai Ming Ling

This article aims to spark the reader's interest and understanding of the development of positive accounting theory, its implications and potential future directions. The development of the positive accounting theory provides much needed hope for detection of earnings management and better corporate governance.

Introduction

Positive accounting theory refers to a theory that attempts to explain and predict current accounting practices (Watts and Zimmerman, 1986). For example, it seeks to explain how and why the capital market reacts to accounting information, and it also seeks to predict the reaction of a firm to a proposed new accounting standard and to explain why the firm would lobby for and against such a standard. Positive accounting theory takes the view that individuals are rational, wealth and utility maximisers. The positive accounting theory is formulated by applying financial-economic theory to accounting. Usually researchers use large-scale samples and the hypotheses are subjected to rigorous empirical testing.

The Development of the Positive Accounting Theory

It is observed that positive accounting theory has evolved through time and changes over the years. The earlier stage of research was based on Capital Market Research (CMR) and the later stage on Accounting Policy Choice (APC). CMR focuses on information efficiency, whilst APC is consistent with the existence of economic consequences. The main premises are :

i) the individual is a rational person and is expected to maximise utility;
ii) the market is perfect and complete (e.g. no transaction costs; information is costless and freely available); and
iii) the investor has homogeneous expectations.

The motivation for and the stages of development of positive accounting theory are discussed as follows.

The Motivation for Positive Accounting Theory

In general, accounting theories can be divided into two types. They are the normative and the positive. According to Jensen (1983), the normative accounting theory presupposes the positive accounting theory. Apparently, the development of positive accounting theory stems from the

dissatisfaction with the normative accounting theories, and thus gives rise to the need for a scientific methodology in response to the limitations of the normative theory. In 1983, Jensen charged that " ... research in accounting has been (with one or two notable exceptions) unscientific ... because the focus of this research has been overwhelmingly normative and definitional". Jensen then called for "...the development of a positive theory of accounting which will explain why accounting is what it is; why accountants do what they do; and what effects these phenomena have on people and resource utilisation".

In 1986, Watts and Zimmerman (W& Z), in response to the argument of Jensen, published a book titled "Positive Accounting Theory". They documented numerous research evidences that they had collected since late 1960s and 1970s. They boldly professed that most accounting theories are "unscientific" because they are "normative" and should be replaced by "positive" theories. W & Z thus emphasise the need for a new approach and they advocate the development of "positive" theories that seek to explain and to predict the actual accounting practice. They provide evidence that the paradigm shift to positive accounting theory enables theories to be refuted, to be explained, to be predicted, to be rationalised to accounting principles and to be linked to accounting, firms and securities markets.

W & Z (1986) also assert that there is pedagogic demand and information demand for a theory (i.e., positive theory) that explains and predicts accounting practice, and that the policy makers also demand for such theory to legitimise their interests. In addition, it is noted that the advances in finance and economic theory, combined with the availability of computers and large databases have also provided the incentives and motivation for the development of a positive accounting theory.

EARLY STAGE

Capital Market Research (CMR)

The early stage of the development of positive accounting theory is based on CMR. CMR is an empirical research using both market price and accounting data. It is based on efficient market hypotheses (EMH) and the Capital Asset Pricing Model (CAPM) from financial economics theories. The semi strong form of the EMH is the form most directly related to accounting. CMR assumes that the market is complete and perfect; investors are risk averse and that investors have homogeneous expectations. CMR focuses on information content, to examine if accounting information affects share prices and ultimately returns. Some classical empirical studies are i) the famous Ball & Brown study (1968). The Ball and Brown study examines the information content of annual earnings; they found that there is an association between stock prices and earnings and this means accounting information has an impact on share price returns;

ii) Ball and Watts (1972), examines the time series properties of annual earnings, and they found that the earnings follow a random walk;

iii) Kaplan and Roll (1972), tests the stock price reaction to accounting procedure changes and their findings suggest that share prices act as if investors "see through" the effect on earnings due to changes of accounting policies.

The CMR studies have been criticised for some of their methodological weaknesses, such as the unrealistic methodological assumptions of market efficiency and self-selection bias of research design. Nevertheless, the CMR findings provide some empirical evidence that there is a significant association between the accounting earnings announcement and the share price reaction. It indicates the usefulness of accounting information. The CMR results are consistent with the hypotheses that accounting information (especially earnings) conveys information to the capital market. They provide the following implications that old news is no news, that the shareholders are interested in relevant new information pertaining to the future cash flow of the firm; that news should be announced as soon as possible; that the market can evaluate and react to the cash flow impact of management decisions and that the policy makers should conduct research to perform cost benefit analysis of the proposed accounting regulation (Belkaoui, 2000).

The CMR provides a major step forward in explaining the effects of accounting and this forms the basic foundation for the construction of positive propositions of the positive accounting theory. However, none of these classical CMR studies address the positive question of why managers change accounting procedure. All of them examine the "*what*" type questions, such as what is the association between stock prices and earnings, stock prices and accounting changes etc. (Zimmerman, 1980). They did not address the positive question of *why* managers change accounting policy and why the Securities Exchange Commission (SEC) and Financial Accounting Standards Board (FASB) adopted a particular form of accounting standard. In brief, the early studies sought to establish if an association did (or did not) exist between two variables but did not seek to explain why such an association did (or did not) exist (Zimmerman, 1980).

LATER STAGE

Accounting Policy Choice (APC)

The limitation of CMR leads to the second stage of research, that is, the development of accounting policy choice theory. At this stage, accounting researchers are in search of a theory that is capable of providing a link between reporting accounting numbers and cash flow, and they also seek to address the question *why* a firm changes its accounting choice. The development of positive accounting theory at this stage is a paradigm shift from capital market to political markets. This shift is partly due to the desire of governments to regulate financial disclosures, particularly, among the accounting standard setting bodies such as Financial Accounting Standard Board (FASB) and the Securities Exchange Commission (SEC) which continuously promulgate setting accounting standards. These standard setters also like to know the impact of their actions.

In 1974, Watts & Zimmerman conducted a study to identify how accounting standards affect the firm's cash flow and the shareholder's wealth. They sought to identify the relevant costs and benefits of al-

ternative accounting procedures. They attempted to develop models of accounting policy choices by applying the economic based theory, i.e., the agency theory of Jensen and Meckling (1976). The agency theory models the firm as a nexus of contracts between several parties such as managers, bondholders, employees, suppliers and consumers. Hence, an agency relationship exists between the shareholder (principal) and the manager (agent) for example. The agency theory also assumes that individuals are rational and want to maximise their utility. The underlying assumption is that "there is no 'a prior' reason to believe that agent will act in the best interests of the principal". Therefore, within the context of the firm, there exists a conflict of interests among all parties. These conflicts cause agency problems and thus give rise to agency costs (such as monitoring costs, bonding costs and residual loss). These agency costs can be mitigated via contracting. As a result, accounting is an integral part of the contracting process as many of these contracts involve accounting variables. For example, employee promotion may be based on accounting-based performance measures such as net income. Contracts with bankers may depend on the liquidity variable. Naturally, firms would want to minimise contracting costs and therefore, researchers argue that the firms' accounting policies will be chosen as part of strategies to minimise contracting costs. The objectives of positive accounting theory are to understand and predict accounting policy choices across different firms, and to find out how accounting policy choices affect the firms' cash flow and share prices.

Three hypotheses form an important proposition of positive accounting theory. They are :

1. the bonus plan hypothesis;
2. the debt covenant hypothesis; and
3. the political cost hypothesis.

Given the flexibility of accounting choice, the managers are expected to take advantage to manipulate earnings. Managers choose a particular accounting policy to either efficiently maximise the value of the firm, or to opportunistically make themselves better off at the expenses of some other contracting parties (Healy, 1985; Sweeney 1994; Christie, 1994). Research findings show that this is particularly obvious if the bonus plan is tied to earnings, and during the period of takeovers, change of chief executive officer (CEO), capital restructuring, initial public offering (IPO) and mergers and acquisitions. Managers manipulate earnings by manoeuvring around discretionary accruals and accounting policy choices. In brief, the ideas in Watts (1974) and Jensen & Meckling (1976) on agency theory form the foundation for current positive research in accounting.

"… the positive accounting theory is not an accounting theory, but rather the sociology of accounting because it concentrates on human behaviour rather than on the behaviour or measurement of an accounting entity … It is the action of the accountant or the preparer that is being studied and scrutinised and not the accounting practice *per se.*"

Criticisms and Debates[1]

The positive accounting theory has generated much debate and criticism. Some writers have criticised the agency theory approach adopted in the development of positive accounting theory for a variety of reasons (for examples, Christensen, 1983; Tinker, Merino and Neimark, 1982; Hines, 1989; Sterling, 1990). Christenson (1983) criticises that the positive accounting theory is not an accounting theory, but rather the sociology of accounting because it concentrates on human behaviour rather than on the behaviour or measurement of an accounting entity. His view is shared by Sterling (1990). Sterling finds that the development of a positive accounting theory is an "anthropological approach" to study accountants (and other people who select accounting methods) and not accounting. It is the action of the accountant or the preparer that is being studied and scrutinised and not the accounting practice *per se*. W & Z (1990) defend this by arguing that an accounting theory that seeks to explain and predict accounting cannot divorce the accounting research from the study of people concerned. The contracting approach to studying accounting requires researchers to understand the incentives of the contracting parties.

Another criticism is that the agency theory (hence the accounting policy choice theory) and CMR make unrealistic assumptions. Both assume that people are motivated purely by economic self-interest, i.e., to maximise utility. Such a research ideology tends to naturalise, legitimise and reproduce such value to individuals. As Noreen (1998, p.368) points out, "by treating such research as an ideal and by teaching it without calling attention to the problematic nature of the assumptions that are treated as normal behaviour, or at worst as an ideal to be striven for ... it is a mistake to wittingly or unwittingly inculcate in the next generation of accountants and managers…" Her view is shared by Hines (1989), who asserts that the positive accounting theory which is influenced by one particular viewpoint in economic thought, i.e. utility maximisation, has the result that

[1] Due to the limitations of space, I shall not discuss the criticisms and debates over the philosophy of science.

accounting serves to bolster particular interest groups in society. Sterling (1990) also argues that positive accounting theory is a research for evidence to confirm the non-nullifiable assumption that people maximise their utility when selecting accounting practice. He says, "positive accounting theory failed to explain and predict how it was being maximised" (p.108). Further, Sterling (1990) states that utility maximisation can be used to explain some behaviour but not all behaviour.

The ontology for positive accounting research assumes that reality exists independently of financial accounting and accounting research. This means positive accounting theory assumed accounting research is value free and socially neutral. Many do not share this view, for example, Tinker (1982) who argues that 'positive' or 'empirical' theories are also normative and value laden, and therefore, all research is value-laden and not socially neutral. Hines (1989, p.56) shares the same view. She states, "By acting in accordance with taken-for-granted assumptions, they (W & Z) do not see that all research is a socio-political endeavour". Her view is further expounded by Sterling (1990), who finds that the value-free study of accounting practice as claimed by W & Z is an unsubstantiated assertion. In addition, Solomons (1986) provides an incisive critique of the positive theory of standard setting. He finds that the development of positive accounting theory, which leads to standards setting, is politicised and influenced by the vested interests of those in power.

In response to the various criticisms and debates on the methodology of their research papers (published in 1978 and 1979), W & Z (1990) give a very simple yet succinct remark. They argue "what is important is that accounting research using this methodology has produced useful predictions of how the world works (e.g. association between earnings and stock prices, random walk models of earnings, contracting and size variables associated with accounting choice. A methodology that yields useful results should not be abandoned; … to most researchers, debating methodology is a "no win" situation because each side argues from a different paradigm with different rules and no common ground." (pp.147-149).

The Future Direction of Positive Accounting Theory

Sterling (1990) considers that the positive accounting theory is fraught with weaknesses and he argues that the actual and potential contributions of positive accounting theory to accounting practice are found to be nil and are projected to continue to be nil. Nevertheless, in my opinion, despite all the methodological weaknesses and various criticisms on positive accounting theory, there are some contributions. The positive accounting theory can be refined in due process with more research. The future direction of positive

accounting theory is very much dependant on the usefulness of the positive accounting theory to various groups of interested users.

Before a theory is proven to be good or useful, it must gain wide acceptance and be able to assist interested users of accounting information to make more correct economic decisions. Due to the rate at which SEC and the standards setters are continuing to promulgate standards, the future development of positive accounting research is optimistic. Models can be developed to measure the relative impact of the new standards, and the policy-makers would be interested to know the trade off between the cost and the benefits of their actions, especially those from developing countries like Malaysia. Further, from the universities websites located on the Internet, it is found that many universities, especially those in the US, Australia and the UK are offering courses in positive accounting theory. This shows that there is an increased interest and pedagogic demand from the academicians and the students. These are signs that this topic has gained acceptance and popularity worldwide.

Recently, Beneish (1999)'s study provides some encouraging evidence. His finding shows some empirical evidence, which is consistent with the usefulness of accounting data in detecting manipulation and assessing the reliability of reported earnings of public-listed companies. The results suggest a systematic relationship between the probability of manipulation and some financial statement variables. This indicates that positive accounting research can be used for fraud detection or detection of earnings manipulation, particularly in the public-listed companies. Recently, with the increase in takeovers, mergers and acquisitions, management buy outs, IPO and corporate restructuring activities going on so rapidly, the positive accounting theory could be applied to assess the earnings management activities of the CEOs.

In recent years, numerous financial scandals and the collapse of financial institutions have been reported in the daily newspapers and electronic mass media. In the international arena, it was the collapse of the oldest bank in England, the Barings bank. Locally, we have the collapse of Omega Securities and the scandals surrounding Sime Bank and the Perwaja Steel Mills. Therefore, it is foreseen that the positive accounting theory would be of great help in the following areas :

1. To evaluate bond rating by rating agencies such as Rating Agency Malaysia (RAM);
2. To detect financial fraud and earnings manipulation;
3. To assess distress or to predict bankruptcy;
4. To assess credit and financial lending decisions;
5. To assess creditability and corporate governance of financial institutions and the public-listed companies.

In my opinion, the general approach that seeks to understand why managers choose the particular accounting procedures that they do remains a very important line of inquiry. It is foreseen that much research will continue to be conducted on earnings management, discretionary accruals, corporate governance, accounting choice and so forth. The future direction of positive accounting theory therefore does look promising.

Conclusion

As we move into the era of information communication technology (ICT), accounting must progress in that direction as well. With the wealth of data on the computers (such as COMPUSTAT, LEXIS-NEXIS, financial data streams, accounting databases, economic databases etc.), combined with the advances in finance and economics, there are important synergies among ICT, accounting, finance and economics. Accounting researchers must be wise enough to seize the opportunity. The development of the positive accounting theory provides much needed hope for detection of earnings management and better corporate governance. AN

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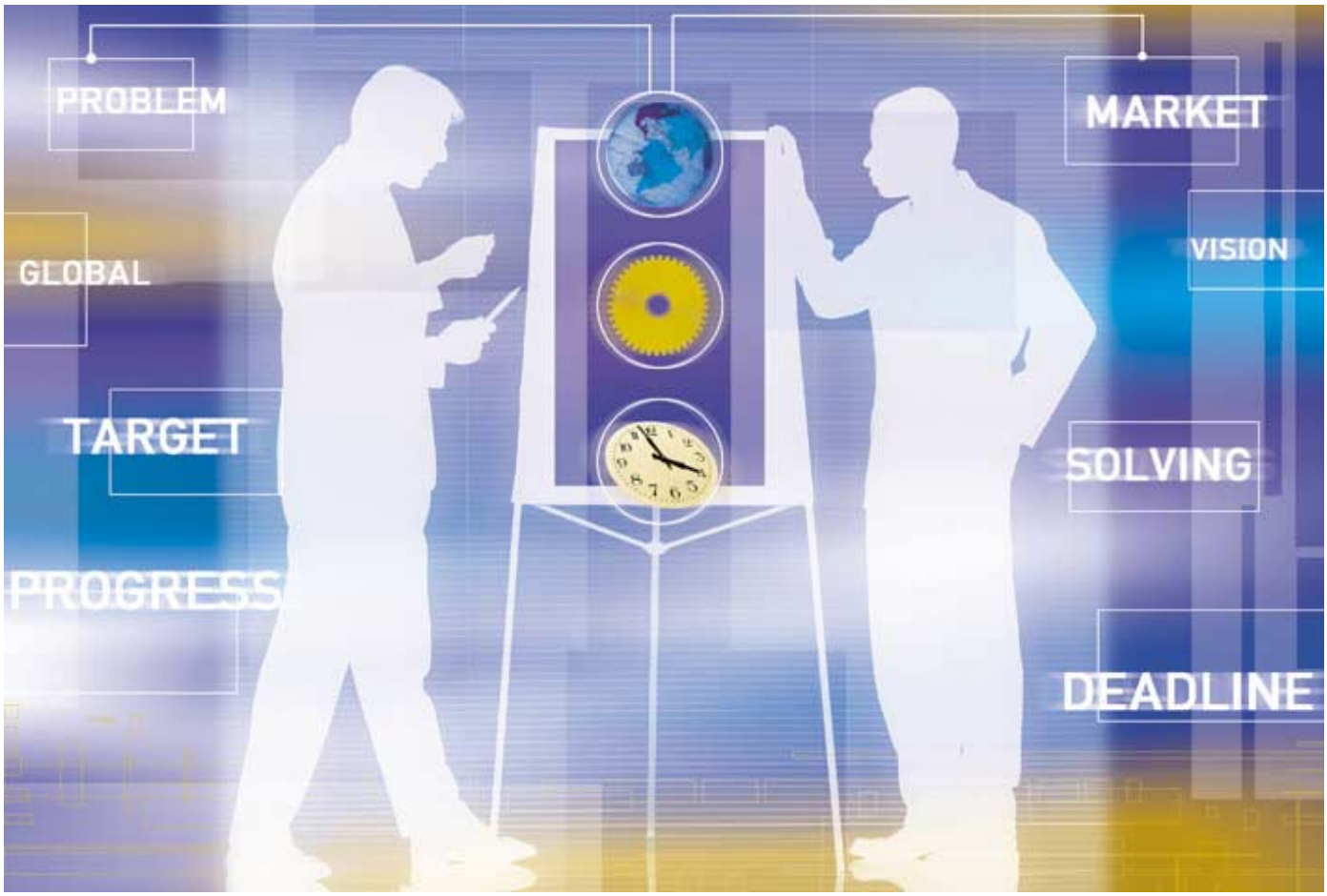
INTERNATIONAL BUSINESS KNOWLEDGE FLOWS

By Dr. Abdul Jumaat Mahajar
DEPUTY DEAN, SCHOOL OF MANAGEMENT, UUM
and Dr. Jeyapalan Kasipillai
ASSOCIATE PROFESSOR AND DIRECTOR OF THE INSTITUTE OF TAXATION RESEARCH, SCHOOL OF ACCOUNTANCY, UUM

Executive Summary

During the last decade, the topic of international business knowledge flows has gathered a lot of interest among corporate leaders. There is a strategic view of knowledge management that considers the synergy between technological and behavioural issues as necessary for survival in today's challenging international business environment. The need for synergy of technological and human capabilities is based on the distinction between the old and new world of business. The old world of business was characterised by a predictable environment focussing on prediction and optimisation of processes. Information was considered a strategic asset and the emphasis was on controlling the behaviour of organisational workers towards fulfilment of pre-specified organisational goals and objectives.

In contrast, the new world of business is characterised by high levels of uncertainty and inability to predict the future. Use of information and control systems and compliance with pre-defined goals, objectives and best practices may not necessarily achieve long-term organisational competence. This is the world of continuous re-inventing and re-engineering, which challenges the assumptions underlying the accepted way of doing things. With ongoing globalisation and liberalisation of financial services, worldwide organisations are increasingly confronted



with intense competition. In order to sustain their competitive advantage, the knowledge and expertise of an organisation's manpower needs to be seen as a critical strategic resource. This paper investigates various aspects of international business knowledge management and probes the relevance of the transfer of knowledge throughout organisations operating on a global scale. Special emphasis is given in deliberating aspects such as advantages and problems that may arise through importing knowledge from abroad by developing countries.

Existing literature postulates that total factor productivity is higher when trade gives countries access to a wider and more sophisticated range of technologies. The transfer of knowledge and technologies has become a critical factor to a company's success and competitiveness. Knowledge transfer is not a static one : it is dynamic and becomes part of the process of continuous learning. Although knowledge and technology transfer has a positive impact on developing countries' total factor productivity, overall developing countries are shown to purchase older and simpler machines or import out-of-date knowledge compared to advanced countries. Moreover, problems also arise in getting the proper ability on how to use the newly acquired knowledge especially those requiring hands-on-experience, on-the-job training, teaching and direct supervision from trainers. Sometimes, governments attempt to limit or select the transfer of knowledge, thereby having a negative effect on the whole transfer project, which could lead to declining productivity in those organisations.

This paper also provides some ideas on how the knowledge transfer flow should be managed. In order to guarantee a successful transfer of knowledge and technology and the creation of a learning organisation, further attention needs to be paid to the management on global assignments. Particular consideration will, therefore, have to be given to the repatriation of expatriates, the efficient use and application of the knowledge and skills gained abroad, and the retention of employees with international experience and competence.

Introduction

The emergence of a knowledge era as an integral part of the global economy has led to dramatic changes in the international business environment. According to Lank (1997), knowledge and its manifestation in the expertise of people nowadays is seen as the greatest asset of value creation for multinational organisations. As businesses are no longer limited by national boundaries, many of the world's corporations, both small and large, are now performing a significant portion of their activities abroad. National boundaries seem to be almost non-existent with an increase in international joint ventures resulting in companies establishing subsidiaries and sales offices outside their home territory. Such changes make it invaluable to organisations if they are to be successful, to manage their knowledge, and to transfer existing skills and expertise effectively within the organisation, especially across national borders. In scaling back global assignments in favour of high cost and sophisticated technology and communication networks, organisations face the real prospect of ineffective knowledge transfer and knowledge management and it does impact the development of the organisation and causes problems for the importing countries.

In both developing and industrial countries there is an increasing institutional awareness of the importance of knowledge for business performance, economic growth and development. The firms in developing countries will choose the type of technology imported so as to maximise their profits. Firms in industrial economies choose the channel through which the transfer technologies are based on profit-maximising conditions. The form of transfer (executed by subsidiaries wholly-owned by foreign investors, joint ventures, licensing, or direct sales of machinery) affects the dispersion of proprietary knowledge and thus monopoly rents. Working at the micro-level allows us to analyse the choice of the type of technology imported and the channel through which it is imported, along with its impact on economic performance. Based on Korea's experience, it shows that technology transfer does have its impact such as resulting in higher productivity.

According to Prusak (1996), knowledge and expertise is created and resides in a person's mind and both knowledge and expertise therefore remain person-bound. So, there is a need to build on old knowledge while inventing new ones, and developing countries must continue creating new knowledge that has been imported earlier. The transfer of knowledge and expertise across national boundaries may require the complete training of both the exporting and importing staff in order to apply company norms and know-how, to set up activities, to educate and to learn. The significance of personal contact then should not be underestimated, especially in global business, where an understanding of cultural difference, such as business behaviour, attitudes, mindset and language can be critical to an organisation's success.

Furthermore, the sudden growth of the information superhighway has facilitated communication and the exchange of ideas on an unprecedented level. The growth of advanced communication technologies such as the internet has not only created vast opportunities for sharing information but is also changing the way international business is conducted. Consequently, the stage is set for international business knowledge flows.

What is Knowledge Management?

Knowledge management or the creation, capture, sharing and use of knowledge have become a fashionable topic of boardroom discussion. Markert (1993) defined knowledge management as a discipline used to systematically leverage expertise and information to improve organisational efficiency, responsiveness, competency and innovation. He went further and added "knowledge management leverages all the key resources that a company already has and that can be put to use in a more effective way". It is something new; individuals and organisations at large have been doing it for years and its only whether they could identify and label them. To our opinion, knowledge management is about managing and growing knowledge assets in the same way as we manage our financial assets. To add further, knowledge management is getting the right information to the right people at the right time plus delivering advanced technology to the desktop to combat information overload. This means, we are entering the intellectual capital world of building knowledge ledger sheets which nobody knows how to do.

Knowledge management has been prac-

tised for over several decades. It has received a lot of attention because of significant movements detected in functional areas such as :

i) Increasing volume of information channels;

ii) Globalisation and competition;

iii) Advancement in technology (computers, communication, software, internet and hardware); and

iv) Awareness of the firm's competitive advantage.

Only by managing data appropriately, can we create wisdom. With technology on the trend of becoming a key commodity, important enterprise resources are people and information. A growing number of multinational companies are appointing Chief Knowledge Officers or Chief Learning Officers. Should Malaysian companies too appoint Directors of Learning or Directors of Intellectual Capital?

Information is a source for good decision-making but a piece of information is more effective when in a context, that is, together with other pieces of related information that make the original information more meaningful and executable. Combination of tacit, implicit and explicit knowledge is what is required here. For instance, a sales quarterly report by a branch office may provide important information, but it is much more meaningful and actionable when analysed in conjunction with the company's operating plan and the industry trends for the year.

Knowledge management can improve corporate efficiency by providing a framework and tools and techniques to re-invent intellectual assets. In this way, resources could be managed to respond to opportunities and threats, and the company's responsiveness could be vastly improved. There are three essential aspects of knowledge management : knowledge discovery, knowledge organisation and knowledge sharing. A simple analogy of these three aspects would be, discovering knowledge where it is — in the heads of people, in workflow diagrams and procedure manuals. This is followed by organising the knowledge according to a company's preferred classification scheme and taxonomy (information tree) and finally sharing the knowledge among those employees that are authorised to know about it and can benefit from its availability.

The discovery, organisation and sharing of knowledge can be accomplished by leveraging current enterprise initiatives and disciplines. Once the knowledge management becomes part of the organisational culture, the organisation will demonstrate elements such as business awareness[1], people network[2], standards[3], tools and rewards[4] and recognition[5].

The Importance of International Business Knowledge Transfer

The success of businesses in the 1990s in an increasingly competitive marketplace depended critically on the quality of knowledge, which those organisations apply to their key business processes. For example, the supply chain depended on knowledge of diverse areas including raw materials, planning, manufacturing and distribution. Likewise, product development requires knowledge of consumer requirements, new science, new technology, marketing etc. The challenge of deploying the knowledge assets of an organisation becomes more crucial due to the following reasons :

i) The marketplace is increasingly competitive and the rate of innovation is rising, so that knowledge must evolve and be assimilated at an ever-faster rate.

ii) Multinational corporations are organising their business to be focused on creating customer value. Staff functions are being reduced, as are management structures. There is a need to replace the informal knowledge management of the staff function with formal methods in customer aligned business processes.

iii) Competitive pressures are reducing the size of the workforce, which holds this knowledge.

iv) There are trends for employees to retire earlier and for increasing mobility, leading to loss of knowledge.

The Process of Knowledge Flow in the Context of Technology Transfer

Successful technology transfer is not achieved through the simple movement of technology to a new environment; it requires the development of a process and infrastructure that will help the technology break through existing barriers. Innovations have to be pushed through the maze of barriers to the end user by the current owner of the technology. The degree to which the end user wants the new technology will determine whether the technological potential or the social constraints will prevail, and the speed with which the innovation may travel from the original source to the end user.

Communication

Communication is a key element in the transfer process. If a new product is available but the public is not made aware of it, the technology will never reach its intended market. Transfer requires human intervention for a technological innovation to become part of a larger system. The communication channels that support the transfer process include printed material (for example, journals, books and newspapers), personal correspondence (letters, conversations), scientific societies and formal instruction (universities and research institutions), travel and exploration and mass media. Obviously, societies that control and limit open communication hamper the process of diffusion and ultimately the successful use of innovations.

Barriers to International Business Knowledge Transfer Process

Technology does not stand alone, but encompasses political, social, economic, personal and cultural values that can serve as barriers that impede the diffusion or transfer of technology. These barriers are deliberated as follows :

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1 Business awareness
- Knowing exactly what each organisation's role is and what it is expected to deliver.
- Knowing who are the customers, partners and suppliers, and mutual expectations and deliverables.
- Knowing the human skills, knowledge and physical resources needed to meet the deliverables.

2 People network
- Communities of practices.
- Ways to locate experts.
- Knowledge brokering.

3 Standards
- Adhering to standards for document creation, content and metadata.
- Creating and managing explicit representations of how to organise knowledge and how it is integrated into overall business.

4 Tools
- Access to and effective use of software tools to help create, capture, organise, store, retrieve, distribute and assimilate knowledge and information.
- Access to and effective use of software tools to help locate expertise and other knowledge workers in any area of interests, wherever they may be in the overall business.

5 Rewards and Recognition
- Values and systems in place that encourage employees to exchange knowledge and information and benefit those who are most effective and leveraging and enhancing the overall knowledge pool of the group.

Political barriers

The influence of political barriers on transfer of knowledge was evident in a problem that occurred in India, where a near-famine situation prompted the development of an agricultural research system and the reform of the bureaucracy that had driven the peasants to poverty (Parayil, 1992). Before the development of the new technology, the colonial government was interested solely in increasing the production of exportable cash crops. In this case, the political agenda largely ignored the needs of the citizens between 1947 and 1965. The political barriers to transfer were not broken until an influential change agent gained a high level position in the government. This change agent pushed the technology through the political barriers by creating partnerships between the government and research institutions that ultimately helped to avert the famine and created an infrastructure in which the technology could thrive.

Social barriers

It is important to recognise that transfer occurs within a social system. The social system defines the boundary or limits within which the innovation will be transferred and diffused. Most transfers assume some sort of societal judgment. An individual will not recommend a technology to neighbours if it is detrimental to them or not of substantial benefit. Similarly, news of a new technology will not be printed in a scientific journal unless its benefit has been adequately proven.

Economic barriers

The role of economic barriers in technology transfer is apparent in studies of the transfer and diffusion of technology to the American cotton-textile industry (Feller, 1974). The adoption rate of a new loom was slow in the North because the industry had a heavy investment in non-automatic looms. In contrast, the new looms quickly spread throughout the South due to a relatively new textile industry that had not yet committed financial resources to a particular technology.

Personal barriers

An individual's particular concern about a given technology seems to be an influencing factor in the degree of acceptance (Hall and Loucks, 1978). Hall and Loucks stress that individuals have different concerns about innovations and proceed through various stages before they fully accept the change. Rogers (1995) also asserts that transfer depends on certain characteristics of the end user. He contends that a very small percentage of the population, called innovators, constantly seek out new innovations. A larger group called early adopters who are generally eager to test new technologies follow this group. This group influences those around them and is often sought out for advice. This is a key group for change agents working to transfer a technology to identify because they can have a strong impact on their peers. Following this group is the early majority who tends to wait until they receive positive feedback from the early adopters about the technology before they become interested in adopting.

Cultural barriers

Cultural barriers also play a key role in technology transfer. In many cases, the culture in which a technology is designed is different from that where it is ultimately used. Thus, it is important for designers to communicate with and understand the receiving culture (Pacey, 1986). This communication will help assure a resolution that is appropriate for the culture and acceptable to social norms and values. Branson (1963) stressed that designers should consider the characteristics of the labour force and the resources available in the receiving country. In developing countries, equipment should be small-scale, rugged, and require minimal training for successful operation. These features should not be limiting, however, as the technology should have the potential to expand as a country's needs and resources expand. He explains that little attention has been paid to accommodating technology designed to cultural traits, instead emphasis has been placed upon adjusting societies to machines. As systems become more automated, those in charge of technology tend to believe that more computer power will make their processes more efficient. In pulling manufacturing and design towards automation, the tendency is to give as much power as possible to the machine and leave the remaining job tasks to the worker. This automation philosophy discounts the knowledge and intuitive capabilities of workers and pushes them to resent the technology. A better approach is to design systems around the workers, which offers the workers a change from mechanistic job tasks to higher level tasks.

The barriers to technology transfer exist for all innovations, but some transfers are more affected by the barriers than others.

Current Situation

In the new knowledge era, national boundaries are less important to business, hence the transfer of internal business knowledge and expertise, and the creation of a "learning" organisation has become a critical factor for a company's survival.

The speed of change, the ferocity of the competitive environment, the shift to service-based industries and the developments in information technology make it a critical task to manage knowledge and retain expertise as significant assets relative to a firm competitive advantage. Companies require quality, value, service, innovation, and speed to market in order to keep pace with, let alone stay ahead of competitors. Organisations are increasingly competing on the basis of their knowledge and expertise as technology can be replicated fairly quickly. It is the people's knowledge that cannot be quickly replicated and copied, as knowledge and expertise have to be created and developed individually. Knowledge can only be employed through people and in this case, an organisation of people becomes the principal source of competitive strategic advantage for the firm. Irrespective of the type and availability of technology, it is people that take in the data, process it, sort it, categorise it, store it in the form of information and use it to build knowledge and create meaning for themselves and expertise for the organisation.

The transfer of knowledge involves both the transmission of information to a recipient and absorption and transformation by that person or group. However, in multinational companies, the knowledge and expertise are transferred across national borders. Many organisations will attempt to move towards a more global model, in which the transfer is seen at least as a two-way process or even a multi-way process, whereby knowledge and ideas are shared and disseminated between the firm's subsidiaries worldwide. For example, through global assignment, Bosch, a multinational company, has the opportunity to transfer skills and knowledge from Germany to Malaysia and then apply those skills to products for local and overseas markets. This move would result in bringing products to the market more

quickly than competitors. As the Malaysian market is relatively small and therefore, has less knowledge available than a bigger market, the transfer of knowledge from Germany to Malaysia is a major competitive advantage for innovation and an important part of strategic success for Bosch in Malaysia. Furthermore, the Malaysian subsidiary is involved in the establishment of a new product range within the Bosch group, and this would make it crucial to secure knowledge transfer and to see the Malaysian subsidiary as a competent partner within the Bosch Group.

As a matter of fact, the development of knowledgeable people and retention of expertise can become problematic if organisations rely simply on real time access to information without the benefit of face to-face-contact. For example, the development in worldwide communication systems, such as e-mail and video conferencing can speed up information transfer to accelerate business or reduce travel for business meetings, but in developing and retaining expertise it cannot fully substitute for face-to-face contacts or long-term assignments. In order to build a personal relationship, establish a network and hence create trust with colleagues or business partners, an environment has to be created that goes beyond interaction via the computer screen.

Concluding Remarks

The choice of appropriate technology depends on the relative cost of factors of production needed to use them. The availability of the required skills in a given firm or country is important in the choice of technology. Skills, such as human, capital or other technical capabilities, acquired through learning by doing or through formal training can be specific to a given technique. The greater the complementary relationship between the required skills and the new technology, the more costly will be the switch to an alternative technology. Thus, this is consistent with the view that the ability for a given country to benefit from the imported technology depends on its absorptive capacity, that is, on its ability to master new and more complex technology quickly and efficiently. These results have three policy implications. First, policies designed to promote technological development should address the complementary relationship between different factors of production. For example, if there are explicit market failures in the education sector, fostering human capital should be a central policy goal. Second, by policies that limit access to foreign capital, in particular, quantitative restrictions on import of used machines are ineffective and damaging. David and Grether (1996) pursued this point further. They analysed several case studies of technology transfer, revealing that the government attempted to select the right technologies to import and in the process prevented local producers from gaining access to the best technologies.

This literature recognises two main mechanisms of knowledge accumulation. The first is that trade may change a country's pattern of specialisation. Learning is faster if the country specialises in goods with high learning potential (Krugman, 1987). The second mechanism is that trade in goods and factors of production may open new sources of technological inputs. Broadly speaking, we can therefore consider two groups of models, those in which learning is essentially a domestic affair and those in which knowledge is imported from abroad. Many of the domestic learning models involve learning by doing. Young (1991), for example, developed a model in which managers and workers acquire experience through the manufacturing process that make them more productive. This well documented phenomenon is typically summarised by a learning curve relating process specific production costs to cumulative units produced.

With a growing global economy, knowledge transfer is increasingly becoming important. Success or failure depends on human factors, such as skills, attitudes, organisational culture and leadership styles and its impact on organisation climate. Malaysia needs to speed up its transformation into a knowledge-based economy from the current production economy (p-economy). The desire of change is pertinent as statistics show that the country is losing its competitiveness to others in the P-economy. The workforce must be able to learn, de-learn and relearn all the technology and international business knowledge transferred.

This paper has emphasised the importance of international business knowledge transfer throughout an organisation on a cross border basis. However the transfer of knowledge and expertise is only one of the many activities and tasks involved in effective knowledge management, which requires the interplay of several of various areas of an organisation. The importance of transferring people is especially important for cross border transfer of knowledge and expertise, and adoption of modern information technology and advanced communication systems. The international knowledge transfer and expertise by means of global assignments effects the area of international human resource management. In order to guarantee a successful transfer of knowledge and expertise and the creation of learning organisations, further attention needs to be paid to the management of global assignments. Particular consideration will have to be given to the repatriation of expatriates, the efficient use and application of the knowledge and skills gained abroad, and the retention of employees with international experience and competence. AN

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NICE TO BE DIFFERENT

But bitter pills must be swallowed for sustained economic growth

By Megan S.

The widely held view is that when Singapore sneezes, Malaysia catches a cold. After recording a 0.8 per cent decline in its year-on-year (y-o-y) economic growth for the second quarter, Singapore is on the threshold of a recession. In tandem with Singapore's economic decline, Malaysia should in normal circumstances follow suit.

However the severity of the slowdown is not likely to be as bad as Singapore. In fact Malaysia is on track to avoid the ignominy of being in the recession boat. The diverse landscape of the economy is the saving grace for the country that has yet to fully recover from the 1997/98 financial crisis.

With the depressed electronic sector, contribution from the plantations and mining sectors are profoundly eminent in the Malaysian economy data this year. Both sectors are expected to register 8.9 per cent growth and 0.8 per cent growth, figures that are much higher compared to manufacturing that is likely to register 0.6 per cent growth.

Prices of crude palm oil (CPO) is off its low of RM700 per tonne early this year to RM1,200 per tonne in July. The resurgence of CPO prices is expected to be short-lived as prices, industry players reckon, will stabilise at RM950 per tonne by the end of the third quarter this year. However the sector's output will be enough to make a significant contribution to the GDP.

Besides agriculture, Malaysia can also take comfort from its exports of crude oil that make up about four per cent of exports. However unlike CPO prices that are almost peaking, the international prices of crude oil has retraced to US$25 per barrel from a high of more than US$33 per barrel in the final quarter of last year. Although lower, the prices of oil are still higher compared to US$20 per barrel early last year.

As put by Dr Mohamed Ariff of the Malaysian Institute of Economic Research (MIER), the plantation and also the mining sectors make the difference for Malaysia in the performance of its Gross Domestic Product (GDP) as compared to Singapore.

MIER became the first government agency to publicly concede that the Malaysian economy is slowing down by forecasting a 2.2 per cent GDP growth in a recent conference. The Treasury report last year touted GDP growth for 2001 at seven per cent while Bank Negara Malaysia estimated it at between five and six per cent.

MIER's gloomy prediction does not come as a surprise. Private economists and small fund management companies with lesser access to official data have since the third quarter of last year predicted that the Malaysia economy would be averaging less than two per cent growth this year.

"... Malaysia is on track to avoid the ignominy of being in the recession boat. The diverse landscape of the economy is the saving grace for the country that has yet to fully recover from the 1997/98 financial crisis."

For instance Tan Teng Boo, the managing director of Capital Dynamics, an independent equity research firm estimated as early as in the fourth quarter of last year that the Malaysian economy for 2001 will be less than two per cent.

Although Malaysia is unlikely to slip into recession, nevertheless growth of about two per cent this year compared to 7.5 per cent last year will send ripples into the economy. Unemployment is rising, exports are falling and the current account surplus is shrinking. Due to the falling reserves, Malaysia's reserves persistently fell from May last year until June this year when there was a reversal.

In the month of June, the reversal in reserves was due to some foreign direct investments (FDIs) coming into the oil and gas sector. Bank Negara's reserves as end of June was US$26 billion, up marginally from US25.9 billion a month earlier.

The reversal in reserves and the depreciation in the Singapore dollar, which saw some hot money flowing into the local stock exchange, improved sentiments at the Kuala Lumpur Stock Exchange. However, considering the global economic scenario, the sudden surge of the stock market is unlikely to last. The exuberance, say some economists, is a precursor to a possible painful economic recuperating process.

According to Dr Ariff, the slowdown is part of the old (1997/98) crisis. The crisis is not over. The export boom lifted us out and now that it is down, we are down again. It is all part of the same old crisis,' he says.

In the aftermath of the 1997/98 crisis, Malaysia made a V-shape recovery on account of its strong manufacturing sector. The huge demand for semiconductors fuelled a stupendous export growth. However the demand for semiconductors has dwindled since June last year without any signs of bottoming up.

The book-to-bill ratio, the benchmark indicator of the supply-demand situation of semiconductors is way below 100 per cent indicating that billing outstrips new orders. Recent reports from the US indicate that the semiconductors will only see a recovery in demand next year.

A distinct difference in the slowdown now compared to the 1997/98 crisis is that there is ample liquidity in the banking system. All three monetary aggregates are growing, albeit at a slower but steady pace. However Non-Performing Loans (NPLs) are beginning to rear its ugly head again, partly because banks have been told by Bank Negara to provide for several loans that were previously given 'exclusion status'.

Previously, banks were allowed to exclude exposure to companies like the Lion Group and the Putra-Star Light Rail Transit (LRT) systems from the NPL list as these loans were pending restructuring by

the Corporate Debt Restructuring Committee (CDRC). However after more than two years, there is no sign of a speedy restructuring.

For instance, the Lion Group's plans to restructure part of their RM10 billion loans that were announced in June last year, has yet to take off as the projected cash flows from its prized mega steel plant are below forecast. The LRT systems RM6 billion exposure is not settled yet although the government has agreed to issue bonds to takeover the liabilities. In a nutshell, because of delays in taking painful measures pertaining to corporate restructuring, the NPLs are rising.

Besides the slow pace of corporate restructuring, another spillover from the old crisis that has yet to be resolved is the severe over-hang of property. It is estimated that there is RM29 billion worth of unsold property. This figure excludes property held by Pengurusan Danaharta Sdn Bhd, the national asset management agency. If not for Danaharta mopping up bad loans from the system, property prices would have gone on a fire sale in the 1997/98 crisis.

Some quarters feel that the second round of economic slowdown will affect property prices most. With higher unemployment, prolonged slow-down in the manufacturing sector and Danaharta having stopped mopping up bad loans, the correction in asset prices is imminent. The last round saw a severe correction in the equity market. This time around, property prices could come for correction.

"Property prices have not gone up for the last few years. But it has not come down either," says a property consultant. "With higher unemployment, new property uptake will be affected. Old properties will come under severe price correction".

To counter the slowing economy, the government has announced an additional RM3 billion economic stimulus to implement several infrastructure projects such as the railway double tracking and Bakun Hydroelectric Dam projects. The RM3 billion fiscal stimulus is in addition to measures announced during the budget last year.

Just like last year, the government is expected to propose a deficit budget this year. However the deficit is not expected to be as large as last year's figure of nearly six per cent. The government has been on a deficit budget since 1998.

In view of further spending on infrastructure and development projects, contribution from the construction and services sectors are expected to be on the up-trend in the next two years. MIER forecasts the construction sector to grow by 3.2 per cent this year and 3.3 per cent next year. The services sector is expected to see a 3.1 per cent growth this year and 4.5 per cent increase next year.

SOURCES OF GROWTH

	Labour	Capital	TFP	GDP Growth
OPP2 (1991-2000)				
Percentage contribution	1.7	3.5	1.8	7.0
Percentage to total	24.3	50.2	25.5	100.0
OPP3 (2001- 2010)				
Percentage Contribution	1.6	2.7	3.2	7.5
Percentage to total	20.9	36.6	42.5	100.0
8th MP (2001- 2005)				
Percentage contribution	1.6	3.1	2.8	7.5
Percentage to total	21.5	41.3	37.2	100.0

Source : EPU

But the key to robust and sustained economic growth is largely dependent on the manufacturing sector that is forecasted to see a 0.6 per cent and 9.1 per cent growth for 2001 and 2002 respectively. This is on the premise that the US recovers by the end of this year.

According to the Eighth Malaysia Plan (8thMP) for the period 2001 to 2005, the economy should average 7.5 per cent annual growth for the nation to achieve its objective of being a developed nation by 2020

However growth by merely increasing labour and capital is no longer enough. A significant portion of growth, says Dr Victor Wee of the Economic Planning Unit (EPU), will have to come from Total Factor Productivity (TFP). (See chart on sources of growth)

TFP is the residual growth that is fuelled after taking into account the inputs by labour and capital. Previously, either increasing labour or capital achieves higher productivity. However due to lower cost centres such as Vietnam and China mushrooming, the value add has to come from the workforce achieving higher TFP.

'There is a need to re-tool the economy and enhance usage of knowledge-based methods to improve efficiency," he said in a conference recently.

According to EPU's long term projections, the TFP should increase from an average of 1.8 per cent in the Second Outline Perspective Plan (OPP2) to 3.2 per cent during the OPP3. The OPP3 is for the period between 2001 to 2010. For the economy to average 7.5 per cent during the 8thMP, the TFP should be about 2.8 per cent. (See chart on Sources of Growth)

Dr Wee dismisses the notion that the ringgit peg is bogging down economic competitiveness of the country. He says that although the regional currencies have softened most, except for Singapore, are not relevant to the Malaysian economy.

As for Singapore, "Although the dollar has softened, it is still much higher than the ringgit," he says. "If the ringgit depreciates, the value add to productivity is less."

Malaysia is not the only country in Asia with a pegged ringgit. Hong Kong, Taiwan and China also have pegged currencies and their competitiveness is in no way dented.

However economic restructuring in most of the countries except for China, is driven by market-based decisions. Rarely are zero-coupon bonds utilised in corporate restructuring. In recent months, the government has given a sound warning to ailing corporations to hasten their restructure plans. The proposed takeover of United Engineers Malaysia Bhd by a Khazanah Nasional subsidiary is a warning to other large corporations.

The Malaysian economy is definitely slowing down this year. We are likely to avert a recession but the lessons will be painful. However the sacrifices may lead to a new foundation for sustained economic growth in the next 10 years. AN

SNIPPETS AROUND THE GLOBE

Lawyer-Accountant Ban 'Anti-Competitive'

In a move that could further erode the barriers to associations between lawyers and accountants, the Advocate General of the European Court of Justice (ECJ), Philippe Leget recently said that a ban on such partnerships was anti-competitive. The article which was compiled by Harvey Morris, the Law Courts Correspondent for *Financial Times*, stated that Leget issued his opinion after a case brought by Andersen Legal, the legal arm of the Big Five accounting firm, against the Dutch bar association.

According to his report, The Big Five have built extensive legal networks and have been engaged in an international campaign to break down what they see as restrictive barriers set up by the legal profession in Europe and elsewhere.

Commenting on the development, Leget was quoted as saying that the "Dutch bar was subject to European competition law and that the ban on multi-disciplinary practices had an appreciable negative effect on competition. However, he added, that the core values of the legal profession had to be protected."

Replying to this statement, Andersen Legal said that "The Advocate General has recognised the strength of their arguments in the area of competition law, rejecting the views of the Dutch bar and the individual member states which argued to the contrary."

A number of European governments have resisted the move towards lawyer-accountant practices and opponents have raised issues of conflict of interest and client confidentiality. Some law firms have argued that the ability of the Big Five to offer integrated legal and accounting services poses a threat to their business.

In Britain, however, the Office of Fair Trading has ruled that a ban on such partnerships is anti-competitive, while in Spain ministers have agreed to allow lawyers and auditors to act for the same client. It may still be several months before the 15 judges looking at the case involving the Dutch bar reach a judgment. The case would then be sent back to the Dutch government.

Although the Big Five are making progress in Europe, the American Bar Association last year killed off a proposal to allow fee-sharing partnerships with accountants in the US.

Source : *Financial Times*, 11 July 2001

Central Bankers Fear the Effects of Strong Dollar

Central bankers from the world's leading economies have expressed concern that the dollar's strength is damaging the economies of the US and Europe. Financial Times reported that the concern was raised by The Governor of the Bank of England and Chairman of the G10, Sir Edward George during the meeting of the Group of 10 central bankers in Basle, Switzerland

His comments, reflecting views expressed by bankers at the meeting which included representatives of the US Federal Reserve and the European Central Bank (ECB), were an unusually frank indication that the leading economies would like to see the dollar fall.

The strength of the dollar against the Euro, has hurt US competitiveness, damaging the manufacturing industry, and hit consumer spending in the eurozone by raising import prices and limiting the ECB's ability to cut interest rates.

Sir Edward's general assessment of the global economic outlook echoed the cautiously upbeat tone of statements by the Group of Seven finance ministers previously. He predicted an upturn in growth in both the US and the eurozone towards the end of the year.

The lack of inflationary pressures meant there was still scope for interest rates to be cut again if there were signs of further global weakness. However, Sir Edward said there had been a general feeling among the G10 that the strong dollar was both "contributing to the imported inflation in the eurozone, which is a factor damping consumer spending", and "exerting a negative effect on the US economy through the trade accounts".

Source : *Financial Times*, 10 July 2001

Sell-off Hits Emerging Markets

Emerging markets were hit by a wave of selling in early July amid growing investor concern about the financial crisis in Argentina. Bonds, equities and currencies in emerging markets around the world extended losses in that particular period in what traders described as the worst turbulence since the crisis of 1997-98.

The trigger for the latest bout of selling was the Argentina government's recent bond auction, at which it was forced to pay 14 per cent interest on three-month paper. Investors have been demanding an increased premium for the risk that Argentina's currency peg to the US dollar will collapse or that the government will default on its debt. Argentina's government has been reportedly saying that it will not default on its debt or devalue the peso.

Such a development has triggered fears among investors in Latin America and other parts of the world. The Brazilian real lost 2.3 per cent to hit a record low of 2.549 against the dollar, leaving it some 30 per cent below the level it started the year, and Brazilian benchmark bonds fell 3.4 per cent.

The Mexican peso, which had seemed relatively immune, fell 1.5 per cent, from 9.14 pesos to 9.28 pesos to the dollar. The Turkish lira fell almost five per cent to TL1,380,000 to the dollar, while Turkish bonds fell 4.5 per cent. In Argentina, the Merval stock index fell 6.6 per cent, while benchmark bond prices fell five per cent.

The crises in Argentina and Turkey had until recently little impact on other emerging markets. Now contagion is hitting other

countries in Latin America, eastern Europe and Asia.

Institutional investors have tried to cut their exposure to Argentina during the last year, as the country's finances have come into question. But Argentine debt accounts for 20 to 25 per cent of all tradable emerging market debt. Investors are selling other assets to cover losses in Argentina and have become more averse to risk because of the worsening global economy.

Paul Meggyesi of Deutsche Bank was quoted saying that emerging markets were able to clamber out of the 1997-98 crisis relatively quickly because strong growth in the world economy was generating demand for exports. That is not likely to be the case this time around.

The slowdown in the US has had particularly severe effects in Asia. In east Asia, meanwhile, the rapid recovery from the financial crisis of 1997-98 is over. Exports, particularly of electronic goods to the US, have slumped. Forecasts of economic growth have been slashed. They will now be cut further after figures from Singapore have shown that its economy contracted at an annual rate of 10.1 per cent in the second quarter.

But, bad as it is, the situation in east Asia is not a repeat of 1997. The countries are not attempting to defend exchange rate pegs, foreign exchange reserves are much healthier and the current accounts of South Korea, Malaysia, Thailand, Taiwan, Singapore, Hong Kong and even Indonesia show healthy surpluses. These countries simply rode the US technology bubble with huge growth in their exports and have stumbled as US demand has hit the buffers.

Restructuring, which had foundered in many countries as memories of 1997 faded must now again take centre stage. Without reform, there is little chance of domestically generated demand and growth. The consequences of difficulties in emerging markets are serious. As long as industrial countries have economic difficulties, the prospects for short-term economic growth are poor. International capital is likely to fly to safer havens, particularly as the International Monetary Fund has shown reluctance to get involved in further bailouts. The risks are high and will remain so as long as economies in the US, Europe and Japan continue to falter.

Source : *Financial Times*, 12 July 2001

Malaysia Can Avert Recession This Year, Says Economist

Malaysia will be able to side-step a recession this year as it still has enough engines of growth to pull its economy through the prevailing downturn and bounce back with a Gross Domestic Product (GDP) of seven per cent next year. This was said by Credit Suisse First Boston regional chief economist P. K. Basu in a recent press interview.

According to him Malaysia would not slide into a recession in the second quarter, like neighbouring Singapore, because in the first quarter, real GDP grew a modest 1.04 per cent, seasonally-adjusted quarter-on-quarter and was expected to hover above the zero mark in the second. He pointed out that a recession was defined by two consecutive quarters of seasonally-adjusted contractions.

He added that he did not see a technical recession. GDP grew seasonally-adjusted quarter-on-quarter in the first quarter of this year and it probably kept its nose above the water in the second quarter too aided by agriculture.

Malaysia's first quarter grew 3.2 per cent year-on-year but contracted 3.7 per cent from the fourth quarter of 2000. It is due to release its second quarter growth figures this month with the slowdown in the United States and slump in electronics demand expected to continue to take a toll on its key manufacturing sector and exports.

According to him factors cushioning the impact of the recession were the counter-cyclical fiscal stimulus taken by the government in March and a surge in tourist arrivals and slower adjustments in the labour market helped buoy private consumption.

Malaysia had announced an additional RM3 billion fiscal package in March to buffer the impact of further deterioration in the global economy. Malaysia's strong petroleum revenues had also bolstered the government's coffers in the past year, widening the scope for enhanced government spending.

Basu said foreign direct investment (FDI) led by multinational companies was likely to take up the slack from private consumption in the last quarter of the year. He noted that FDI approvals over 12 months to May this year, totalling RM28.17 billion, were the strongest ever for any 12-month period.

He said, given the nine to 18 months lag between approvals and inflows, this should be very positive for FDI inflows in the fourth quarter and through much of 2002, hence our top-of-the consensus forecast of seven per cent GDP for 2002.

He added Malaysia's previous highest FDI approval over 12 months was RM20.66 billion to September 1992. In the last five years, the strongest FDI approvals over the same span were RM17 billion to December 1996. Underlining his bullish outlook, he said the manufacturing sector would gain from the modest recovery of the IT sector globally.

Source : *New Straits Times*, 21 July 2001

Slowdown Turns to Recession in Singapore

Singapore authorities released new economic data recently indicating the wealthy island city-state has fallen into recession, with second quarter growth contracting by an estimated 0.8 per cent. The Singapore dollar fell to a 11-year low in early July when the news was released.

The Singapore Government lowered its economic growth estimates for 2001 to 0.5 per cent to 1.5 per cent, down from the already revised 3.5 per cent to 5.5 per cent. At the beginning of the year it estimated the island-state's economy would grow about five per cent to seven per cent in 2001 following 9.9 per cent growth in 2000. Singapore's growth contracted by 0.8 per cent in the second quarter of 2001 compared to the same period last year.

The figure is considerably less than the 4.5 per cent growth in the first quarter compared to the same time in 2000, and a blistering 11 per cent growth in the fourth quarter of 2000. The recession is a result of the cyclical slowdown and not because Singapore has become less competitive, and Deputy Prime Minister Lee Hsien Loong was quoted as saying that the island state's competitiveness is not a problem. He explained that the country's exchange rate has been quite stable on a trade-weighted basis.

The downturn in Singapore followed negative GDP growth in the first quarter in Taiwan and Thailand and slowing growth in South Korea and Hong Kong. All have been hit by falling demand in the US and Japan and by the downturn in technology-based industries such as telecoms.

Source : *Financial Times*, 11 July 2001

STILL FLYING HIGH

By Haris Hussain

Don't panic! Despite a high-profile cancelled order and falling yields, the US airline market is not in crisis … yet !

One of the first alarm bells of an economy in decline is that businesses stop sending goods around. How busy trucking firms and air freight carriers are, and whether they are updating their fleets, is a fairly accurate barometer of the industry's real state. It often comes months after confidence ebbs from the stock market, which in some ways represents the 'virtual economy'.

That's why Federal Express's (FedEx) decision to cut back on its MD-10 conversion programme and defer orders for Airbus A300s and Boeing MD-11s is a worrying sign that the Federal Reserve's attempts to wrench the ailing US economy back on track are failing — despite some encouraging economic indicators recently.

The concern now must be that passenger airlines will be next. When the 'dot bomb' exploded late last year, high-flying executives and internet entrepreneurs found themselves rapidly downgraded from executive jets and first class to business class, and their middle managers from business class to economy class. In the first six months of this year US business jet sales have slumped 30 per cent and airlines have been forced to discount heavily to fill empty seats in their premium cabins.

America's big five airlines are certainly feeling the pinch. Northwest last week told employees that job cuts could be on the cards despite reducing costs by US$200 million already. American Airlines, currently digesting TWA, warned investors they might have to swallow a loss this year.

But so far the wobbles in the US economy have not impacted significantly on new passenger aircraft deliveries. There are three reasons for this. Firstly, airlines have had to face up to revamping ageing fleets as tougher environmental laws threaten to make older models obsolete; both United Airlines and Delta Air Lines have just announced plans to cut capacity by retiring aircraft. Secondly, most airlines seem prepared to ride out this slump — which, do not forget, is barely six months old — staking their hopes on the economy reviving in time for their acquisitions to come on-stream.

"Limited infrastructure and air space, rather than economic conditions, appear to be the main brakes on continuing upward demand for air travel in the US over the next decade."

And, thirdly, the burgeoning regional jet market — the result of an increasingly prosperous and mobile population — has kept aircraft plants at full tilt. However, this is where things get doubly-worrying. Just at a time when passengers are getting scarcer, pay expectations by pilots threaten to shatter the fragile arithmetic on which the regional airline marketplace is based. Comair's truce with its striking pilots may have got its 26 services from Cincinnati back in the air, but it has left the relationship between unions very much up in the air. A round of pay negotiations between regional airlines and their pilots' representatives will now have the Comair deal driving the agenda. It is likely to lead to major airlines thinking twice about relying on regional partners to provide feeder services between hubs and some of the less significant destinations on their network.

For the wider prognosis on the US airline market, though, you do have to look beyond the industry to the economy as a whole and, indeed, to the longer term. And there the outlook is better. The latest quarter point cut in interest rates may not have been the leg-up many were hoping for, but it means interest rates, at 3.75 per cent, are 2.75 per cent lower than they were in January. Although businesses in the technology sector in particular have been laying off staff, consumer confidence is holding up. Limited infrastructure and air space, rather than economic conditions, appear to be the main brakes on continuing upward demand for air travel in the US over the next decade.

If the aircraft manufacturers are panicking about the future, they are hiding it well. At the Paris air show Airbus reinforced its orderbook with 175 more aircraft and Boeing's market forecast too was fairly bullish. The airlines, concerned about delivering quarterly good news on passenger yields to their shareholders, may be nervous, but longer-term, the US airline market is in good health.

Meanwhile, FedEx is to curtail its Boeing MD-10 conversion programme and defer delivery of Airbus A300 and Boeing MD-11 freighters because of the weak US economy and falling demand for domestic express services. The package carrier has also cancelled its orders and options for the Ayres Loadmaster feeder freighter, effectively killing the programme.

FedEx will not complete the last 29 of a planned 118 DC-10 to MD-10 conversions. The aircraft, now stored for passenger-to-freighter conversion and installation of the MD-10/MD-11 common cockpit, will be broken up for spares forcing FedEx to write off US$93 million.

The carrier says it will honour its contract with Boeing to take 89 MD-10s by 2006, "unless we can negotiate that number down". FedEx has received the first six MD-10s, and a further nine will be handed over by year-end, says Boeing Airplane Services. The aircraft are being converted by Aeronavali in Italy, SR Technics in Palmdale, California, and ST Mobile Aerospace in Alabama.

The airline says it is "right-sizing its domestic express network" after seeing average daily volume decline six per cent year-on-year in the fourth quarter ending 31 May. Other actions include the retirement of 30 Boeing 727-100 freighters by 2006 and the deferral of A300 and MD-11 freighter deliveries scheduled for next year into 2003 and 2004. FedEx was to take delivery of two A300-600s, four A310-200/300s and four MD-11s next year.

The company has written off US$9 million in deposits and other costs on the Loadmaster programme. "It would be great to have the aircraft, but it is not going to be built, so we have terminated our commitment," FedEx says. This is likely to force Ayres into liquidation. The airline says it will continue to use Fokker F27s, until a "right-sized" feeder freighter becomes available.

FedEx is the latest carrier to announce capacity reductions in the face of a slowing US economy. American Airlines is to retire 22 aircraft, including TWA's fleet of 19 McDonnell Douglas DC-9s, by the first quarter 2002 instead of over the next three years. This will reduce capacity by one per cent.

United Airlines has phased out its DC-10s and accelerated the retirement of its 727s, but still expects capacity to increase two per cent by year-end as it takes delivery of new A319s,A320s and 777s. Delta AirLines plans to cut capacity by 1.5 per cent by year-end, removing 10 aircraft, including seven 727s, from its fleet.

United Parcel Service says it continues to evaluate its network. It says it has made no decision on reducing capacity, but "three or four" 727-100 freighters have been placed in short-term storage.

"… one carrier seems to be unfazed by the worrying trend in the US. Growing tourism forecasts are driving a reappraisal of the Dubai-based carrier's strategy for the next 10 years and Emirates is finalising a new business plan which is set to result in a huge increase in fleet size by the end of the decade."

Meanwhile, one carrier seems to be unfazed by the worrying trend in the US. Growing tourism forecasts are driving a reappraisal of the Dubai-based carrier's strategy for the next 10 years and Emirates is finalising a new business plan which is set to result in a huge increase in fleet size by the end of the decade.

The rapidly expanding Dubai-based carrier has been working on the plan since early this year following a request from its owner, the Dubai Government, to reconsider its strategy after an increase in tourism growth forecasts for the region over the next 10 years.

"We will tell our shareholder what is possible in the next couple of months," says Emirates chief director, Tim Clark. The 16-year-old carrier has been growing capacity at an average of 20-30 per cent per year, despite a strict control on ensuring an above 70 per cent passenger load factor.

The growth has been built on the back of the increasing importance of Dubai as a trading centre, combined with the hub strategy that Emirates has pursued at the United Arab Emirates airport. Its network now includes over 50 destinations.

The airline's all-widebody fleet comprises of 34 aircraft — four Airbus A300/A310s, 17 A330-200s, nine Boeing 777-200s, and four 777-300s. A further 17 aircraft are on firm order including five 550-seat Airbus A380s and two A380 freighters. The airline's original plan had envisioned its fleet steadily growing to about 55 aircraft by 2010, but the expansion is now likely to be much greater.

"We're looking at what's possible, given the normal prerequisites : i.e. if we continue to be profitable, we can fund the expansion from the international markets and we can grow our infrastructure to cope" says Clark. Although he will not confirm the rumoured 200-plus aircraft target, he says that in the analysis of potential fleet growth "we're into some big numbers". Clark says that he anticipates the 20-30 per cent annual growth will continue. The fleet plan being studied assumes an all-widebody fleet, he adds.

The next stage of Emirates' fleet development will begin late next year when deliveries begin of its six ultra-long-range A340-500s. These will allow the airline to launch direct flights to the US (including the west coast) and Australia.

Clark says that its 10 options could be exercised as the larger A340-600 if Airbus is able to meet Emirates' performance requirements. "We need an aircraft that can carry a 45 ton payload from Dubai on 14 hour missions in temperatures of 40-45 °C (104-113°F)" he says.

The airline aims to be involved in the definition of Boeing's proposed sonic cruiser high speed airliner, and sees applications both for premium passenger markets and time sensitive freight. AN

ACCOUNTING STANDARD MASB 6 — The Effect of Changes in Foreign Exchange Rates

By Norita Mohd Nasir
LECTURER, SCHOOL OF BUSINESS AND INFORMATION TECHNOLOGY
MONASH UNIVERSITY, MALAYSIA

INTRODUCTION

Accounting for the foreign currency transactions and operations of Malaysian firms is governed by *MASB 6 — The Effect of Changes in Foreign Exchange Rates*, which was made mandatory and legally enforceable from 1 July 1999. The standard supersedes the *IAS 21 (Revised) — The Effects of Changes in Foreign Exchange Rates,* which was effective from 1 January 1998. The requirements of MASB 6 are consistent, in all material respects, with IAS 21 (Revised), except for the hedge accounting and the treatment of exchange differences in equity and their offsetting[1].

The principal issues in accounting for foreign currency transactions and foreign operations lies with the usage of the exchange rates, and the translation of the foreign financial statements. Prior to the adoption of the MASB standards, studies showed that most Malaysian firms disclose their foreign exchange policies, but the compliance to the requirement under IAS 21 (Revised) regarding the translation of the profit and loss statement at the average rate was minimal (Abdul Latiff, 1997, Ng, 1998). Having the standard enforceable by law for reporting periods after 1 July 1999, the current study attempts to provide the most current reporting and disclosure of foreign currency transactions by Malaysian public-listed firms.

The remainder of this paper is organised as follows. Section two provides a brief description on *MASB 6 — The Effect of Changes in Foreign Exchange Rates*, followed by a discussion from previous findings. Section three discusses the methodology of the study, and section four provides the empirical evidence and the interpretation of the results. The final section summarises the results, followed by the concluding remarks.

Prior to the adoption of *MASB 6 — The Effect of Changes in Foreign Exchange Rates*, the Council of the Malaysian Institute of Accountants (MIA) had approved *IAS 21 — Accounting for the Effects of Changes in Foreign Currency Exchange Rates* effective from 1987. In addition to the standard, a note recommending the use of the closing rate to translate the profit and loss items accompanied.

On 1 January 1998, IAS 21 (Revised) was made effective, in which it superseded IAS 21 previously adopted. However, following the establishment of the independent standard setting body under the Financial Reporting Act 1997, *MASB 6 — The Effect of Changes in Foreign Exchange Rates* became operational for the reporting periods after 1 July 1999. The requirements of the standard are consistent, in all material respects, of the IAS 21 (Revised) except for the hedge accounting and the treatment of exchange differences in equity and their offsetting[1]. However, inconsistency between MASB 6 and IAS 21 lies in respect of the treatment of the exchange differences on long-term monetary items for the period before 1 July 2001. Before this date, firms were allowed to continue to defer and amortise exchange differences arising from the translation of long-term foreign currency monetary items, accompanied with the notes to the accounts.

Two main issues in accounting for foreign currencies are — accounting for transactions in foreign currencies and translating the financial statements of foreign operations.

Accounting for Foreign Currency Transactions

On initial recognition, foreign currency transactions should be recorded by applying to the foreign currency amount the exchange rate between the reporting currency and the foreign currency at the date of the transaction (Para. 9). At the balance sheet date, foreign currency monetary items should be reported using the closing date, except when there are related or matching forward contracts in respect of trading transactions, in which case, the rates of exchange specified in those contracts should be used. Non-monetary items which are carried at the historical cost or fair value of the foreign currency, should be reported using the exchange rates at the date of transactions, or when the val-

[1] The MASB standard permits a limited aspect of hedge accounting to be applied to trading transactions covered by forward exchange contracts, as well as foreign currency liabilities and other financial instruments which are designated as, and which provide an effective hedge of, net investments in foreign entities and foreign equity investments. The standard also places extra conditions for the treatment of exchange differences in equity and their offsetting, besides further disclosures of items relating to exchange differences included in the income statement.

ues were determined, respectively (Para. 11). Exchange differences arising therefrom should be recognised as income or expense in that period (Para. 15). However, exchange differences arising from long-term foreign currency monetary items should be classified as equity and offset against the exchange gains or losses.

Translation of Foreign Financial Statements

The method used for translating foreign financial statements depends on the way in which the foreign operations are financed and operate. Foreign operations can be classified as either "foreign operations that are an integral part to the operations of the reporting enterprise", or "foreign entities". A foreign operation that is integral to the operations of the reporting enterprise carries on business as if it was an extension of the reporting enterprise's operations. Any exchange differences resulting from the exchange rates of such transactions directly affect the cash-flow from operations of the reporting enterprise.

On the other hand, the following factors, if present, indicate that a foreign operation is a foreign entity :

1. the activities of the foreign operations are carried out with significant autonomy;
2. transactions with the reporting entity are not a high proportion of the foreign enterprise's operations;
3. its activities are financed mainly from its own resources or through local borrowings rather than the reporting entities' funds;
4. cost of labour, material and other components of the foreign operation's products or services are paid or settled primarily in the local currency rather than the currency of the reporting entity;
5. the sales are primarily made in currencies rather than the reporting currencies;
6. cash flow of the reporting enterprise is insulated from the day-to-day activities of the foreign operation rather than being affected directly by the activities of the foreign operation.

However, in practice, the criteria of such operations can be very subjective and vague. Therefore, caution must be exercised in classifying the foreign operation as this will determine the method used to translate the financial statements.

The financial statements for foreign operations that are integral to the operations of the reporting entities should be translated as if the transactions had been those of the reporting enterprise itself (Para. 27). However, for foreign entities, the following procedures apply (Para. 30) :

a) the assets and liabilities, both monetary and non-monetary, of the foreign entity should be translated at the closing rate;
b) income and expense items should be translated at the exchange rate at the date of transactions, except for the case of hyperinflationary economy, in which the closing rate should be used;
c) all resulting exchange differences should be classified as equity until the disposal of the net investment.

Previous Studies

Abdul Latif and Skeratt (1997) examined the 1995 annual reports for KLSE listed firms. During that period, *IAS 21 — The Effects of Changes in Foreign Exchange Rates* was still at the exposure draft stage. In the study, they found that 94 per cent of Malaysian firms disclosed policies on foreign exchange in their reports. Transactions outstanding at the year-end were measured at the year-end or contracted rate and almost all firms charged the transaction differences to the profit and loss account. For the foreign operations, only 38 per cent and 33 per cent of the firms translated the balance sheet and profit and loss items at the year-end rate, respectively. On the other hand, only 10 per cent of the firms used average rate to translate their profit and loss items, as recommended by the IAS 21. Overall, they concluded that majority of the firms comply with the requirements of IAS 21, even though it was still at the exposure draft stage. However, a significant minority of the firms were found to be diverted from the international requirements without any explanation for the treatment.

Another study by Ng (1998) on the 1996 annual reports found that 92 per cent of the firms presented an accounting policy on foreign currency transactions. However, only two per cent disclosed specific accounting policies on the treatment of unrealised exchange differences arising from long-term foreign currency monetary items. He also concluded that all of the firms disclosing the accounting policy on foreign currency translation used the closing rate method to account for the translation of financial statements of foreign operations. However, only 23 per cent of these firms used the average rate to translate the profit and loss items. His study was based on *IAS 21 (Revised) — The Effects of Changes in Foreign Exchange Rates*, which was issued by MIA effective from 1 January 1998.

Methodology

Sample Selection and Data Sources

This study examines all firms listed on the Kuala Lumpur Stock Exchange (KLSE) main board, which have their annual reports on the KLSE website (internet), as at 22 May 2001. A total of 778 firms were found to have been in the KLSE list, including the second board. Out of this, only 349 main board firms have posted their year 2000 annual reports. One firm was excluded due to the failure to access the file. The year 2000 reports is chosen to get the most recent pattern of the firms examined, after the enforcement of the accounting standards by law.

The industry profile of the 348 firms under investigation is shown in Table 1 :

TABLE 1 Distribution of firms according to the sector

Sector*	Number of firms
Construction	26
Hotels	5
Consumer Products	41
Plantation	25
Industrial Products	74
Mining	5
Trading/Services	63
Properties	51
Technology	8
Finance	43
IPC	3
Trust	4
Total	**348**

* as classified by the KLSE
Note : The data for this study is of public domain. They were gathered from the KLSE website.

TABLE 2

Policy disclosures on transactions by sector

Sector*	Policy disclosed		Non disclosure	
	No.	%	No.	%
Construction, n=26	23	88.5	3	11.5
Hotels, n=5	5	100.0	0	0.0
Consumer Products, n=41	39	95.1	2	4.9
Plantation, n=25	20	80.0	5	20.0
Industrial Products, n=74	71	96.0	3	4.0
Mining, n=5	3	60.0	2	40.0
Trading/Services, n=63	59	93.7	4	6.3
Properties, n=51	39	76.5	12	23.5
Technology, n=8	8	100.0	0	0.0
Finance, n=43	39	90.7	4	9.3
IPC,n=3	2	66.7	1	33.3
Trust, n=4	1	25.0	3	75.0
Total	**309**		**39**	

TABLE 4

Policy disclosures on transactions of foreign financial statements by sector

Sector*	Policy disclosed		Non disclosure	
	No.	%	No.	%
Construction, n=26	14	53.8	12	46.2
Hotels, n=5	2	40.0	3	60.0
Consumer Products, n=41	21	51.2	20	48.8
Plantation, n=25	13	52.0	12	48.0
Industrial Products, n=74	35	47.3	39	52.7
Mining, n=5	2	40.0	3	60.0
Trading/Services, n=63	42	66.7	21	33.3
Properties, n=51	23	45.1	28	54.9
Technology, n=8	4	50.0	4	50.0
Finance, n=43	24	55.8	19	44.2
IPC,n=3	1	33.3	2	66.7
Trust, n=4	0	0.0	4	100.0
Total	**181**		**167**	

TABLE 3

Distribution of firms according to the policy choices — foreign currency transactions

Current Study	Previous Study		Ng 1998		Abdul Latif 1997	
	No	%	No	%	No	%
Exchange differences dealt with in PL	286	82.1	*	*	88	88
Exchange differences dealt with in PL, Unrealised Exchange Differences from Long Term Foreign Currency Monetary Items Deferred and Amortised	23	6.7	2	2	0	0
Exchange Differences Charged to Others	0	0	0	0	5	5
No Policy Disclosed	39	11.2	8	8	1	1
Total	**348**		**100**		**94**	

* did not specify

Empirical Results

This section provides some evidence on the reporting practice after the adoption of MASB 6. Two issues of interest in discussing the practice of foreign currency exchange are the accounting for foreign currency transactions and the translation of foreign currency financial statements. Table 2 provides the distribution of the firms on the policy disclosures of the foreign currency transactions according to the sectors. Overall, most of the sectors reported a high percentage of disclosure on the foreign currency transactions' policy, except for trust, mining and IPC. However, the number of firms under these sectors is very small in comparison to the other sectors (refer to Table 2). On the other hand, 12 firms under the property sector did not disclose any policies, which represents 23.5 per cent of its sector, or 30.7 per cent of the total non-disclosure firms.

Further analysis on the policy choice of the foreign currency transactions reveals that most of the firms (88.8 per cent) recorded the exchange differences resulting from the foreign transactions in their profit and loss accounts. However, 6.7 per cent of the firms were found to have specified their method in dealing with the long-term foreign currency monetary items, in comparison to two per cent in Ng's (1998) study. Firms not disclosing any policy regarding the foreign currency exchanges increased gradually from the previous studies, from one per cent to eight per cent and finally 11.2 per cent (refer to Table 3).

Firms' distribution on the disclosures of the translation of the foreign financial statements according to the sectors is shown in Table 4. The disclosure level is relatively lower in comparison to the foreign currency transactions (refer to Table 2), possibly due to the non-existence of the foreign operations for these firms. Generally, except for the trust sector, only 50 per cent of the firms in each sector disclose their policies regarding the translation of the foreign financial statements (Table 4).

Analysis on the accounting policies adopted to translate the foreign currency financial statements is shown in Table 5. Contrary to the previous study, a reverse pattern is evidenced in which Malaysian firms are found to be providing more disclosures in comparison to the period before the standard was adopted (52 per cent in comparison to 30 per cent). However, the number of firms not disclosing the policies is still high (48 per cent in comparison to 70 per cent). Interestingly, 4 firms,

TABLE 5 Distribution of firms according to the policy choices — translation of foreign currency financial statements

Method	Current Study		Previous Study Ng 1998	
	No.	%	No.	%
Policy disclosed	181	52.0	30	30
Policy not disclosed	167	48.0	70	70
Total	**348**		**100**	
Classification of Foreign Operations				
Integral operations	2	1.1	0	0
Foreign entities	26	14.4	30	30
Integral and Non Integral	4	2.2	0	0
No policy disclosed	149	82.3	0	0
Total	**181**		**30**	

TABLE 6 Foreign entities — rates to translate profit and loss items

	Current Study		Previous study			
			Ng 1998		Abdul Latif 1997	
	No.	%	No.	%	No.	%
Average rate	97	54.2	7	23	10	10.6
Transaction rate	21	11.7	0	0	0	0
Closing rate	52	29.1	21	70	33	35.1
No policy	9	5.0	2	7	51	54.3
Total	**179***		**30**		**94**	

* 2 firms classifying the foreign operations as integral operations are excluded.

which do not disclose any accounting policy for the translation of the foreign currency exchanges, reported balances in their Exchange Fluctuation Reserve Account.

A change in the pattern of classification of the foreign operations is also found. 82.3 per cent of the firms did not disclose any policy regarding their foreign operations, while only 17.7 per cent clearly stated their foreign operations as integral, non integral or both (refer to Table 5). However, the number of firms classifying their foreign operations as integral parts of their operations is still very minimal, with only 1.1 per cent and none for the current and previous study, respectively. The subjectivity in classifying such operations in MASB 6 (Para. 27 and 30) is seen as the factor contributing to this phenomenon. The simplicity in applying the closing rate method for the foreign entities is one of the possible factors contributing to the choice. Under this method all assets and liabilities are translated using the closing rate of exchange. Another possible reason is the treatments of the translation differences arise from the translation. Under the closing rate method, the differences are brought to the reserve account, bypassing the profit and loss statement, leaving the profit unaffected.

Analysis on the firms classified as "foreign entities" is shown in Table 6. More firms were found to have used average rate in translating their profit and loss items (10.6 per cent to 23 per cent and currently 54.2 per cent). A significant number of firms have applied the transaction rate of exchange (11.7 per cent). This indicates that Malaysian firms are complying with MASB 6 requirements in which the income and expense items should be translated at the exchange rate of the dates of the transactions (practically the average rate is used).

The usage of the closing rate method has declined to 29.1 per cent from 70 per cent as it was reported in the last study, while the percentage of firms not disclosing any policies in translating their profit and loss items has declined from 54.3 per cent to seven per cent and finally five per cent. The findings suggest that, relatively, Malaysian firms are more transparent in disclosing their accounting policy and have shown a high degree of compliance to the MASB 6 (as shown in the application of the average and transaction rate of exchange for the profit and loss items).

Conclusion

The purpose of this study is to provide current reporting practice for the Malaysian public-listed firms, in regards to the accounting for foreign currency transactions, after the MASB 6 was made enforceable by law. Generally, it was found that most of the firms disclosed their policies on the foreign currency exchange. Classification by the sectors reveals that firms under the property sector contribute the most to the non-disclosure group of the foreign currency transactions. Analysis on the policy disclosure of the translation of the foreign financial statements indicates that except for the trust sector, the disclosure level of the firms under other sectors is moderate.

Further analysis on the policy choices on the translation of the foreign currency financial statements showed only 17.7 per cent of the firms clearly stated their classification of the foreign operations, either as integral or non-integral to their operations. However, analysis on the rate used to translate the profit and loss items reveals that, 65.9% of the firms have complied with the requirements of MASB 6 in which requires the usage of the average or transactions rate of exchange. The moderate compliance of the MASB 6, for the first year after its adoption, provides a positive signal to the standardisation of the treatments for the translation of the foreign currency financial statements in the near future. AN

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Financial Planning Approach to Investment Strategies

By Yap Ming Hui
MANAGING DIRECTOR, WHITMAN INDEPENDENT ADVISORS SDN BHD

Note : This article is a continuation from the writer's earlier article, which appeared in the June 2001 issue of *Akauntan Nasional*.

CRITICAL STEP 4

Invest with a Master Plan

Applying the concept of asset allocation allows you to balance the expected returns and market risks of various class of investment to achieve the results that will best meet your goals in a master financial plan.

Asset allocation is the selection of diverse, uncorrelated types (or classes) of investments to maximise portfolio return and minimise risk. The word "uncorrelated" is key. It means that the various types of investments that are selected will perform differently in any given set of economic and market condition. The types of investment will complement each other; when one is up, the other will be down, smoothing out the performance of the overall portfolio and reducing its volatility.

Proper investment planning based on the principle of asset allocation has the following levels and decision-making to be made at different levels :

Level 1 : *Personal Philosophy* (Understand and identify how we think, feel and act as investors)

Level 2 : *Investment Objectives* (Visualise and verbalise what it is we are trying to accomplish in our financial life)

Level 3 : *Asset Allocation* (Structure and design our investment portfolio to balance the relationship between our goals and our risk tolerance)

Level 4 : *Security Selection* (Select investment instruments that have the best possible chance of meeting our needs and goals)

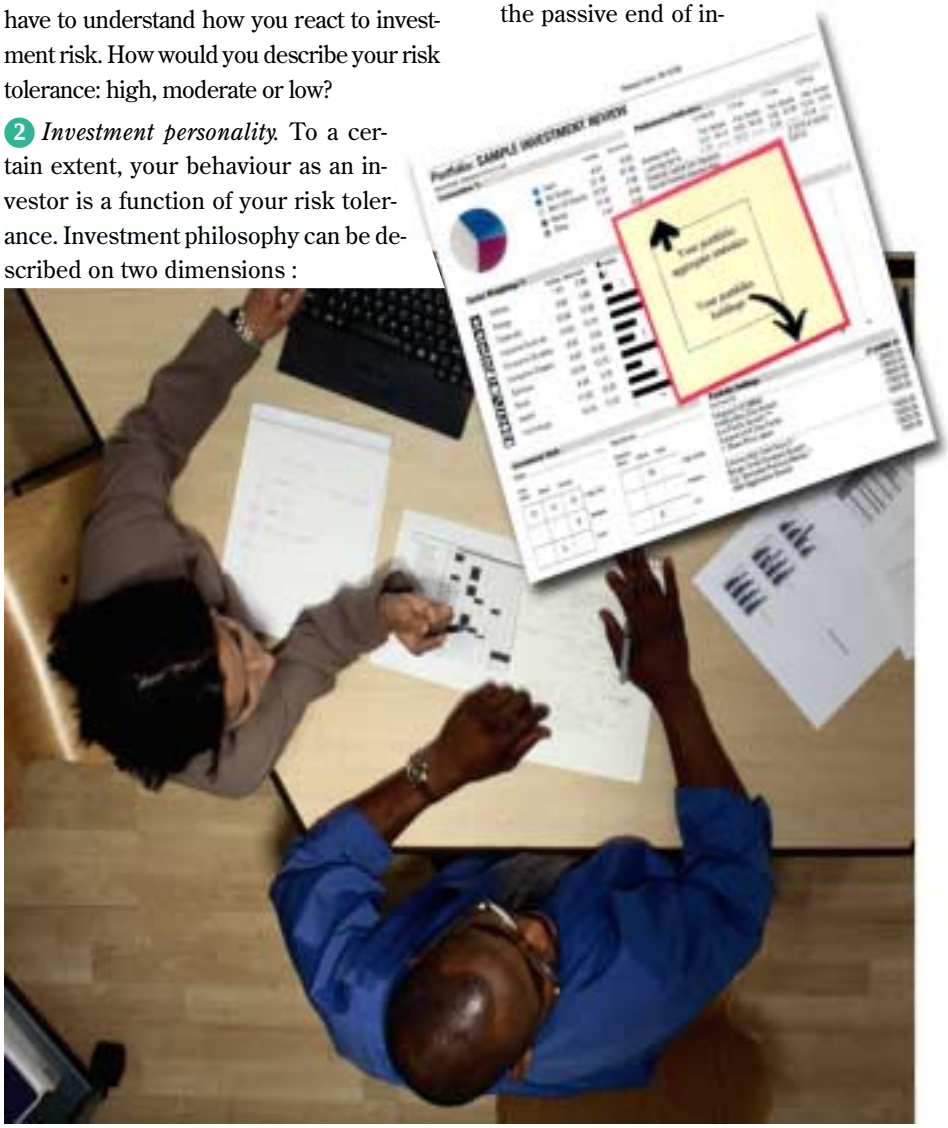
Level 1 : *Investment Philosophy*

There are two stages in developing investment philosophy.

1 *Risk tolerance.* As an effective investor, you have to understand how you react to investment risk. How would you describe your risk tolerance: high, moderate or low?

2 *Investment personality.* To a certain extent, your behaviour as an investor is a function of your risk tolerance. Investment philosophy can be described on two dimensions :

- **Involvement** — the degree to which you want to be involved in day-to-day decision making for investment. Find out whether you fall closer to the active or the passive end of in-



vestment involvement. However, there is no good or bad place to be; successful investor personalities can be found all along the continuum.

- **Spontaneity** — market timing or money management. Market timing is logical but deceptively simple – buy when the market is going up and sell when the market is going down. Money management diversifies an investment portfolio among a few asset classes in accordance with an investor's risk profile and investment expectations.

At the end of Level 1, you should be able to develop your investment philosophy by putting all three components together. An example of investment philosophy can be a statement as follows : "I am a *moderately risk tolerant* investor who wants to *be passively involved* in a *money management approach* to preserving assets and achieving reasonable growth."

Level 2 : *Investment Objectives*

There are really only three things we hope to achieve with our investment portfolio — growth, income or liquidity. We want our assets to grow in value — to be worth more at some point in the future than they are today. After we have accumulated whatever amount of wealth we can, we want to be able to convert those assets into income to replace salaries, business earnings or allowances. And finally, we want to have some amount of liquid emergency or opportunity fund so that we don't have to dramatically alter the investment plan.

If we were to examine closely, there is a logical connection between those three objectives and the basic asset classes. That connection looks like this :

Objective	Asset Classes
Growth	Equity
Income	Debt
Liquidity	Cash

Based on experience, most of the clients would have an investment portfolio that is too small to achieve all their goals given reasonable assumptions about investment performance. Even though there is always a possibility to set a target rate of return for portfolio to meet objectives, the volatility (risk) may be too high for an investor to be comfortable with. In proper investment planning, it is usually better to focus on risk rather than return. Once your risk tolerance is established, it sets an upper limit on the portfolio's long-term expected rate of return. If the rate of return is inadequate to meet your objectives, those objectives have to be scaled down or your commitment to save more money to the task must be increased. A suitable investment portfolio should be the one that best balances objectives and tolerance for risk.

An example of investment objective is as follows : *"My primary investment objective is growth over the next 15 years. I do not anticipate a need for income from my portfolio before that time, although I would like to have some funds available for an emergency or opportunity."*

Level 3 : *Asset Allocation*

The old adage "Don't put all your eggs in one basket" has been around for years. Way back somewhere between 1200B.C. and A.D.500, the Jewish Talmud counselled, "Let every man divide his money into three parts and invest a third in loan, a third in business and let him keep a third in reserve." Of course, both our world and the investment markets are more complicated now but the wisdom of diversification continues to be sound and relevant.

Asset allocation has become the buzzword of the financial service industry. In the purest form, asset allocation answers two basic questions :

1. What types of assets should I have in my portfolio?
2. How much of each should I have?

Level 3 : *Asset Allocation* takes the concepts developed so far and put them into action. The asset allocation decisions you make will be the framework for constructing your portfolio, but their long-term usefulness will be directly related to the strength of the underlying assumptions about your personal philosophy and objectives.

The asset allocation step can be achieved by answering the following question : "Given my personal philosophies (risk tolerance and investor personality) and my objectives, what percentage of my assets should be allocated in equity, what percentage in debt (bond) and what percentage in cash?"

If your primary objective is growth, you should include a significant amount of equity in your portfolio because equities have historically shown the highest rate of growth. If it is to provide income, you should have a considerable amount of debt-type assets because they offer the most consistent income flow and if the objective is liquidity, cash-type assets should probably dominate, as they are most liquid.

An example of an Asset Allocation Statement is as follows : *"My portfolio will be composed of 10 per cent liquid, 20 per cent income and 70 per cent growth assets. With this combination, I expect a long-range average return of approximately 10 per cent and an average volatility of +- 11 per cent."*

Level 4 : *Security Selection*

The last step in the investment portfolio design process is to choose the specific investments we want to include among our holdings. This is the part of the investment process in which many of us want to spend most of our time because it is the most fun and exciting. It is also where we think we can have the most impact. So let's look at how we handle this part of the process.

THE SECURITY SELECTION PROCESS

1. Divide each asset class into meaningful components and assign weighting to each component to parallel your risk profile. If I want to start with equity, I must begin by dividing the equity part of my portfolio into the risk categories of conservative, aggressive and speculative. Then I would assign weighting to each of these components to parallel my risk profile.
2. For each component, develop a list of securities with which you are comfortable. "Now, with what type of equities am I familiar and comfortable with?" Bear in mind that whatever securities you choose should give you some confidence that they will meet your needs and be within your tolerance for risk.
3. Evaluate the list of potential investments in terms of your perception of risk by matching each choice to the descriptions I have developed.
4. Assign dollar values to each chosen investment.
5. Repeat for each asset class. When moving into the next largest component-debt, the process is the same. Only the

subdivision is different. For example, You may want to subdivide the debt portion of the portfolio by maturity date of the potential holdings, short-term (1-2 years), mid-term (3-5 years) and long-term (5 years and above). Finally, when it comes to the cash portion, you may want to subdivide it into liquid and very liquid.

THE SUCCESS OF SECURITY SELECTION

It is very important to emphasise that the success of security selection is very much dependent on how many alternatives you are exposed to. If you only have very few options limited to existing life insurance and unit trust, there is nothing much for you to improve you security selection. However, if you are able to consult a competent financial consultant, he may be able to offer you a wide and comprehensive list of alternatives, some not even widely available to normal investors. As a result, you would have a better chance to further diversify your investment portfolio and smoothen your portfolio under various circumstances.

An example of a security selection statement is as follows :

"My portfolio will have the following types of securities :

Cash	Very Liquid	__ %
	Liquid	__ %
Debt	Short-term	__ %
	Long-term	__ %
Equity	Conservative	__ %
	Aggressive	__ %
	Speculative	__ %

CRITICAL STEP 5

Implement and Stick to the Investment Plan

You now have a completed Investment Planning Statement that tells you what to do as far as putting together an appropriate investment portfolio. The next question is how to start implementing the decisions you have already made. Obviously, if you were to start with only cash holdings, which you were now going to diversify among the securities you had chosen, the task would be much simpler than if you had a portfolio of existing investments to try to restructure your plan.

If you already have a portfolio of investments, begin by theoretically converting all your existing assets to cash. Then you can deal with the asset allocation and security selection decision from the ground up, so to speak. Calculate the total dollar value of your investments and then compare where you are with where you want to be.

Rebalancing the Portfolio

Asset allocation decisions you make initially are not fixed permanently — they can be changed at any time and, indeed, should be re-examined on a regular basis. Based on historical record, equities will normally outperform all other assets in the long run. As a result, it is inevitable that over an extended time horizon, the equity portion of your portfolio will grow faster than the debt and cash components. Therefore, the equity side, if left unchanged, will gradually represent more and more of your total holdings. If that happens, what you should do is to sell a certain portion of equity to buy more cash and debt investments, prorating the purchase of each to return the portfolio to the original asset allocation percentage.

Psychologically, this is not a very easy action to take if you have had good experience on the equity side. You need to sell off the assets that have given you the best returns to buy more of the ones that have not performed as well. However, if you want to maintain the risk profile of your portfolio that is exactly what you must do. And, of course the theory also works the other way around — when the equity portion of the portfolio falls below its initial allocation, you have to sell some cash and debt assets to buy more equities. Otherwise, the inflation-fighting potential of your portfolio will be curtailed. The other major advantage of the rebalancing tactic is that is disciplines us to adhere to one of the key tenets of successful investing, that is "buy low — sell high." Rebalancing a portfolio on a periodic basis automatically forces us to do that.

The Temptation to Stray From Your Investment Plan

It is one thing to have effective investment planning strategies conceptualised and designed according to your circumstance. It is another thing to stick to your investment strategies — even when it is performing according to your expectations.

There are many reasons why an individual investor strays from an investment plan that is achieving their objectives. The first reason is the search of the thrill – the sense of adventure and satisfaction in seeking out the next Microsoft, Yahoo or Amazon.com. Some investors indulge in the idea that they can best the professionals, relying on their cleverness and ingenuity. The satisfaction is to prove that they are better than others in selecting the right stocks. They believe that by regularly reading the many financial publications they can become insiders in regard to information that gives them some advantage. This false notion gets investors all excited and confused.

The second reason why an investor would stray from his plan is the never-ending allure of so-called get-rich-quick schemes (*Skim Cepat Kaya*). However, as the saying goes, "If this sounds too fast, too easy and too real to be true, it most probably is."

The third reason that makes the investors abandon their successful investment plan is envy. They seem to have the impression that everyone else is making tons of money from the share market. This false conclusion can result from listening to friend's bragging or media coverage of day trading success stories.

In many other cases, investors are lured from effective investment plans because of something as simple as a convincing sales pitch from a financial product salesman. Most often, they do not know these salesmen, their background and professionalism. More importantly, these salesmen do not know much about them as well.

As such, it important to be an informed investor who sticks to an investment plan. Do not get caught up in the investment noise. Do not respond to tips or market timing.

We have come a long way together to understand investment strategies developed based on our master financial plan. By combining a sense of what we want in life and who we are with a deeper understanding of sound investment principles, we would have a better chance to achieve financial goals in life. Despite the simplicity and straightforwardness of the financial planning approach, it is still easier said than done. It is one thing to understand the concepts and quite another thing to put the principles into action with discipline over the long term. However, if we are really serious about achieving what our families and we deserve in life, do not hesitate. Get into action and stick to your investment plan. AN

Don't Waste People's Time, Please

By Robert Khaw

Bad Moments of Truth

The other day I was at the Immigration Department to pay my domestic helper's levy. To cut the story short, it took me nearly one and a half hours just to submit a cheque and get the maid's passport stamped.

I was thinking if a depositor, on average, takes around 15 minutes to bank in a cheque, why can't the Immigration Department do the same? Indeed, one can now bank in the cheque in an "Express Cheque" box without having to line up.

On another occasion, at the Bandar Utama shopping complex, I witnessed a long queue of traffic offenders snaking their way to pay their fines. I met someone who had given up paying his fine. He had waited around an hour, and there was at least another half-hour of waiting to go. I can understand why he gave up — his legs must have been aching; moreover, it was dinner time.

These experiences are in sharp contrast to those I had during my student days in Melbourne. Somehow, the buses and trams turned up at around the stated time in the schedule posted on the board.

Not so over here. Spending time waiting for buses seems to be the norm rather than the exception. At times, this unsatisfactory state of affairs extends to even the taxi services, especially during peak periods. Indeed, some Singaporean seminar participants complained recently about the unduly long wait (nearly an hour!) for taxis, not to mention the non-metered charge.

Perhaps, you can recall your own experiences. Communication experts call these experiences "bad moments of truth". Sadly, such stories stick to us like super-glue.

The above examples are cited, not with the intention of singling out any particular department or sector. Rather, it is to drive home the point that people don't have a lot of time to waste. The public sector at all levels (federal, state and local authorities) and the private sector should be mindful of this — and the faster, the better.

Time — A Neglected Resource

It is often said that time is a resource that is even more precious than money. Some may dismiss this as a cliché, but no one can disagree that time, once passed, cannot be recovered or replaced. With money, we still have the possibility of making good if we were to lose it. That explains why time is more precious than money.

Now, what has all this got to do with the economy, especially the New Economy?

In the industrial age, capital, labour and land used to be the key drivers of the economy. Not so nowadays, given the emergence of knowledge as the dominant economic resource, which has been greatly facilitated by the rapid developments of information and communications technology (ICT), globalisation and liberalisation.

But whether in the industrial or knowledge-based age, the efficiency with which the scarce time resource is harnessed and deployed is just as important in determining a country's economic performance. Yet, the time resource element as a factor of national productivity and competitiveness is usually relegated to the back-seat.

Given that things are now moving at a faster speed, the time factor should be elevated to its rightful place. Why? Because the more time is wasted needlessly, the worse it will be for a country's competitiveness.

Time-based competition demands a much higher level of operational efficiency and organisational effectiveness. The local car manufacturer would need to come up to world-class speed in introducing a new model. The financial market intermediaries would need to shorten the time they take to convert time-sensitive data and information into knowledge so as to create value, and hence beat the competition. The regulatory bodies would need to expedite its processing time, so as to support the private sector.

Unfortunately, precious time is squandered daily, and no one bothers to calculate its cost to the nation. Add up the countless wasted hours over the years due to gross inefficiency and ignorance, and we may be shocked with the total. For example, commuters could well be spending anything between one and two years in traffic jams during their working lives!

No one needs to tell us that being caught in a gridlock is an unproductive activity. And such time wastages can, in turn, adversely affect national productivity and people's social well-being.

"A tunnel was built below the 63rd Street in New York a few years ago, which saves some seven million commuter hours a year." Reported in Discovery Channel.

Don't Do Unto Others ...

The time has come to generate a greater awareness of the precious time resource and the need to use it more efficiently. A sustained nationwide triple "A" (awareness, advocacy and action-oriented) campaign is needed, both in the public and private sectors.

At the educational establishments, our students shouldn't merely be taught how to read the clock. They should also be taught the value and management of time, and its impact on individual productivity and national competitiveness.

Beyond that, people who are in a position to influence other people's use of time should no longer waste their time any further. People who serve others should realise that they too are customers, as they would need to buy services or products from others. And as customers, surely we wouldn't want others to waste our time, would we? And the moral of the story? Don't do unto others what we don't want others to do unto us, i.e. waste our time.

"Time-based competition demands a much higher level of operational efficiency and organisational effectiveness."

It is time we learned to empathise with the frustration other people feel, and realise that no customer enjoys marking time in our office. If possible, they would want to get into the Guinness Book of World Records by getting out of our waiting room in record time!

Interestingly, Albert Einstein once said : "Imagination is more important than knowledge." We can certainly apply this dictum in serving our customers. We need to imagine that our customers have far more important things to do elsewhere than to be held 'captive' in our office.

No one needs to tell us too that a lengthy wait is not without its cost, which can take different forms, e.g. missed business or social appointments, increased stress or higher parking fees. It can also result in increased risks on the road, as some drivers may try to make up for lost time by stepping on the accelerator. Also, unhappy customers with bad waiting experiences are likely to create bad publicity for the organisation concerned. They may even lodge complaints about the inefficient service to the management or highlight it in the press.

Practically Speaking

What then can be done to deal with the above problem which is inextricably linked to the national economy?

At the practical level, creative techniques such as brainstorming can be used to minimise the wastage of time in the public and private sectors. Ample time should be allotted for periodic brainstorming sessions. The goal is to continually find innovative solutions to eliminate, for example, overcrowded and stuffy waiting areas, unsightly long queues, backlogs, bottlenecks, red-tape and so on.

Incidentally, such inefficiencies or their manifestation tend to create opportunities for corruption. It goes without saying that the faster these problems are dealt with, the better it would be for the public, investors and our country. The cost of doing business and cost to individuals will also be reduced.

The time has also come to review the way we do things, for example, ascertaining if :

- Certain procedures or requirements can be minimised or sent to the recycling bin;
- Certain payments and forms can be submitted electronically without requiring customers' physical presence; and
- The run-around imposed on people can be eliminated.

Ideally, such a review should form part of the organisational system. The review process should be made mandatory and conducted periodically, not a one-time event following a complaint. The need of the hour is a proactive attitude, not a reactive one.

Understandably, manpower, financial and technological constraints can adversely affect the delivery or quality of service. Therefore, every effort should be made to deal with the resource constraints speedily, so as to better serve our customers. Improved service delivery will contribute to enhancing national productivity and competitiveness.

A related issue is the incentive system, which should reward performers. Customer feedback is a useful criterion in helping to determine the quality and delivery of service by a department, branch or an individual, as well as the quantum of reward.

Together, let's plug the leakage on the precious time resource — the faster, the better for our customers, organisations and nation. AN

Note : Robert Khaw is a Senior Manager in the Technical Department (Strategy & Planning) of the Malaysian Institute of Accountants (MIA). This article is a revised version of the one that first appeared in *The Edge*, 25 June 2001. The views expressed in this paper are the author's and do not necessarily reflect the opinion of MIA nor can the Institute be in any way held responsible for them.

Self Management

By Jarod Roch

These days, the workplace has lost some of its sacrosanct aura to what can be termed as almost brutal management control tactics. Management plans where you are going as far as the company's organisational ladder is concerned and let's face it : if you run into trouble with a particularly nasty sort in upper management, boom goes your chance of going anywhere up the organisational ladder.

If you don't take charge of your career or if you are complacent enough to let the management manage your career for you, only one thing can happen. Your career is not going to go anyplace anytime soon or if it does, 90 per cent of the time, it's not going in the direction that you want it to. There's only one way to stop this and that's by taking charge of your life and your career and making it go the way that you want it to go.

That's why we need self-management methods to help steer one's career in the right direction. Employed in this sense, career management is the term that refers to the dynamic process through which individuals gather information on the world of work, develop career goals and implement strategies to achieve them. All in all, it is a steady and sure climb up the path of corporate success.

Of course, all this would have been unnecessary a couple of decades ago when it was enough to punch in your nine to five each day and take home the wages at the end of each month. However, the progress and development of the age of information technology has sounded the death knell to such ideal workplace ethics and ideologies. Heightening global competition in many industries has led to the re-structuring and re-aligning of organisations. This re-structuring has led to employees experiencing work differently as environments are more uncertain and the 'old style' of work and approach to career management is disappearing rapidly.

What we have now is an ever-changing kaleidoscope at the workplace with the most consistent characteristic being inconsistency itself. You can never tell what's going to happen tomorrow, whether you'll still have your old job or not. The emerging work environment is one in which individuals are ultimately responsible for managing their own careers. The more traditional vertical progression of career paths is being replaced by lateral mobility, and the nature of work is becoming more unpredictable.

One sure and certain way towards successful self managed careers is for individuals to become self-reliant and assume ownership of their own destiny : in other words, plan you own career paths and have a goal in mind as to where you want to be say 10 years down the line. Such a career plan is driven by you, the individual, as opposed to they, the management, and such a *modus operandi* has the added advantage of being flexible enough to be re-invented or modified to allow you to achieve your goal.

Another key concept is to cultivate the skill of tolerance for ambiguity and self-awareness. The idea is that by becoming proficient in these areas, an individual will be able to manage himself effectively. A good way to encourage such a mindset of personal responsibility for career management is by attending development programs that emphasise skills relating to self and interpersonal knowledge.

For individuals to have ultimate responsibility for managing their careers, self-knowledge is required in order to become adaptable and flexible and a process of continuous learning is necessary in order to meet the demands of change. Remember that self-knowledge contributes to career management by heightening employees' awareness and understanding of themselves while interpersonal knowledge contributes to career management by helping to foster a network of relationships. This is further enhanced by environmental knowledge, which contributes to career management because it helps develop an understanding of the context in which work is done.

It is clear that an increased awareness of self, of others and of environment can help an individual to make informed career decisions. They illuminate self-development and enhance career management and effective career management will consist of an individual engaging in lifelong learning, self-assessment and networking both inside and outside an organisation.

Despite the new concept of career requiring individuals to be personally responsible for their careers, organisations can in fact become partners in the system instead of acting as impediments against their employees' self managed careers. The best way for organisations to do so would be to provide resources to enable employees to cultivate this new mindset and give them encouragement to be courageous enough to take a step towards the realm of self managed careers.

By working with an employee towards his or her goal instead of taking a negative view towards self managed careers, organisations will tend to gain more. The employee will be able to appreciate all that the organisation is doing for him and in return will show loyalty towards his company. Studies have shown that employees are reluctant to leave organisations that are pro-employees as they appreciate all the benefits that have been accorded to them.

As such, done in the right way with the correct mindset and attitude, self-managed careers can have a dually beneficial role towards both employee and employer. AN

Overcoming SUCCESS GUILT

This common malady cannot only impede your progress, but make you feel unworthy of what you've already accomplished.

By Norman M. Lobsenz

When a television executive was promoted to a top spot in a network, a friend planned a party to toast his success. "Please don't," the executive said, "do you know why I really got the job? The man I was competing with for the job suffered a heart attack and had to go on sick leave. Everyone thinks I was moved up on merit – but I know I was just dumb-lucked into it."

Not long ago I called to congratulate a colleague whose new book was climbing up the bestseller list. She sounded more depressed than exhilarated. "I don't understand it," she said, "the book's just not that good. I feel like a fraud."

A Los Angeles attorney, recently made a partner in his prestigious firm, was dining with friends in a rooftop restaurant overlooking the lights of the city. There was much talk of his forthcoming vacation to the Orient. Suddenly the man broke into tears. "I'm sorry," he said when he recovered his self-control, "I was thinking of my older brother. He was a brilliant lawyer who died of leukaemia when he was only 32. He deserved all this more than I do."

Incidents like these illustrate a deep but seldom-recognised psychological conflict some men and women experience when confronted with career success. While the spirit of Horatio Alger is still alive and well in America, and most people want and strive to be successful, many of them are afflicted with a sense of guilt when they achieve that goal.

In a little-known essay called "Those Wrecked by Success." Sigmund Freud wrote : "There are people who find success unbearable … it seems as though they are not able to tolerate their happiness. Freud was referring largely to a phenomenon now known as the "fear of success." Several recent studies bear out the fact that many people, consciously or unconsciously, do something to avoid climbing the career ladder; they fall ill at crucial times, suddenly alienate a boss or a customer, or quit just when they are about to be promoted. (Researchers say that because of cultural stereotypes, women seem to be particularly susceptible to the fear of success.) But the television executive, the writer and the lawyer were not so much afraid of success, as they were guilty about having what they felt was an undeserved triumph.

"Guilt feelings," psy-

chologist Allan Fromme once observed, "are an inevitable accompaniment of the development of our consciences." But why should anyone be conscience-stricken by success? And what can one do to recognise and deal with the problem? To explore these questions, I recently talked with a number of successful men and women, and with experience familiar with the psychology of guilt.

Andy Littlejohn (whose name, like others in this article, has been changed to protect privacy) is, at 36, chief of engineering design for a West Coast aircraft company. "It's an important job for someone my age," Littlejohn says, "but I don't enjoy it as much as I should because I know what it cost my family." In the past 10 years, his family has been up-rooted six times to keep pace with his job changes and promotions.

"I've interrupted my children's schooling and separated them from their friends," he says. "I'm a stranger to my kids, I've neglected my wife. I'm a success at work and a flop at home."

As women increasingly seek and win worldly success, they, too, are guilt-plagued by having to choose between work and marriage, career and children. Susan King, a San Diegan who is now a senior executive in a New York bank, broke off a two-year love affair to take her new post. "He didn't want me to go, and I didn't want to lose him," she says. "Now I keep wondering if I gave up the most important thing in my life."

If success imposes such emotional sacrifices or demands key compromises, of oneself or one's intimates, it is often accompanied by guilt. But there are many other, more subtle causes of success-induced guilt feelings. Here are seven common causes :

1 When you don't believe in what you are doing.

The son of one of my friends has just been made chief of a project to improve the accuracy of guided missiles. "I know a lot of my colleagues envy my position," he says, "but I'm trapped in a moral dilemma. If I do my job well, all it means is the likelihood of more destruction and death. I grapple with personal guilt all the time."

A management study reported in the Harvard Business Review recently pointed out the 'moral misfit' that occurs when a successful person feels he or she is compromising basic values for money or prestige : A sales manager, sucessful at his job, did not believe in the merits of the product he was selling. After an important sale, rather than feeling proud of himself, he would come out feeling "Thank goodness that's over."

"Women who compete and win top jobs often feel guilty about being too assertive."

2 When success comes at the expense of violating one's personal code of behaviour.

"I did a lot of things I'm ashamed of to get where I am." one man admitted. A woman confessed that she had, against her values and judgment, traded on her sexual attractiveness to get ahead. "I've never admitted it before," said the vice president of a public-relations firm, "but I played a lot of hardball office politics along the way. That's what gnaws at me now."

3 When success comes at the expense of others.

Several people said they felt guilty because they had been promoted over older men ("He's been with the firm so much longer than I have") or over friends ("We used to work together : now she has to take instructions from me") In one case, two senior editors at a publishing company were in competition for the editor-in-chief spot. "When I got the job," the winner says, "it meant my colleague had reached the end of the line here. He quit within a month, and he's still unemployed. I know I shouldn't feel guilty, but dammit, I do!" And according to family counsellor Marcia Lasswell, "Women who compete and win top jobs often feel guilty about being too assertive. They feel they have violated traditional norms of how a woman is supposed to act."

A new novel by Philip Caputo, *DelCorso's Gallery*, plays on this theme. Its hero is a photojournalist who "has it made — beautiful wife, two smart kids, a fancy brown-stone and spacious studio. What he doesn't have is the ability to enjoy any of it. DelCorso's guilt stems from knowing that the pain and death of other men, recorded in his war photos, made him successful.

4 When success seems meaningless because it fails to meet the standards of one's internal measuring rod.

By all odds, Producer Aaron Spelling (creator of Charlie's Angels, Hart to Hart, Love Boat, Fantasy Island and other TV hits) is one of Hollywood's prime success stories. At 54, he has travelled from a ghetto childhood in Texas to a lavish Beverly Hills estate and an office the size of a tennis court. Yet in a recent interview in the *Los Angeles Times*, Spelling confessed, "I'm basically a happy man, except for this terrible need to do something a little bit better. I should stop producing this crap and go back to writing what I want to say … about the goodness of life."

5 When expectations continue to outreach accomplishments.

Because most successful people have always been achievement-oriented, they have high expectations for their own performance. "Guilt," writes psychoanalyst Willard Gaylin, "is a form of self-disappointment. We have fallen short. We have somehow or other betrayed some internal sense of potential."

By most standards, Cary Likert is a successful musician : he works steadily, playing in regional orchestras, and has composed one well received sonata. But Likert' remains guiltily dissatisfied. He says, "I've never made it to a major symphony, and that's the only way I measure success in my field."

Sometimes it is the expectations of oth-

ers that turn career success sour. Bill Garbett owns a profitable plumbing supply business yet is plagued by the knowledge that his parents expected him to be an attorney. "I just couldn't hack it in law school," he says, "I graduated, but far down in my class. Eventually I went back to college to study marketing and worked my way up in sales and merchandising jobs. By all realistic standards. I'm a successful businessman but I still feel guilty about disappointing my folks."

6 Self-image does not mesh with outward success.

As we have seen, some people feel their good fortune is undeserved because they should be accomplishing more than they are. Conversely others feel guilty about 'undeserved' success because it clashes with their low self-image.

A highly productive salesman says : "I'm always afraid my boss will find out that I'm not good at the job, that it won't last." Such men and women see their success as an 'accident' or an unwitting deception.

"When one's self-image does not match one's accomplishment," writes psychiatrist Leon Tec, "success is often tinged with guilt."

7 When there are subconscious conflicts.

Freud blamed the Oedipus complex — a man's repressed desire to defeat or exceed his father for much unconscious guilt.

"To achieve more than that powerful authority figure may seem dangerous or disloyal," says psychotherapist Judith Davenport from Santa Monica, California. "It is emotionally risky to outdo one's father, and so one induces guilt as a self-punishment." On the conscious level the successful son (or daughter) of a hard-working but unsuccessful father may feel guilty at having been rewarded more lavishly in life than the parent.

Success-linked guilt is a very real phenomenon, but since it so often stems from unconscious motivations, how can you recognise the syndrome? Experts in both management and psychological counselling suggest that you check this list of eight basic questions which can serve to alert you to the situation :

- Am I enjoying my career accomplishments in a realistic way?
- Does my work fulfil the broader goals I hope to achieve in my life?
- Do I believe that what I am doing in my job is a valuable contribution to society? (Clearly, a "No "answer to any of these questions may be an early warning signal that guilt feelings are building.)

"Be kinder to yourself. Learn to appreciate your strong points. Build your self-esteem."

- Do I unnecessarily play down my abilities or efforts?
- Do I secretly feel overpaid? (a "Yes" response can be a sign that you feel your success is undeserved.)
- Am I supercritical of my own work?
- Do I make things harder for myself on the job than necessary.
- Do I take needless risks in my work? (again, a "Yes" answer may indicate that you set ever higher standards or even court failure in an unconscious desire to absolve yourself of success-related guilt.)

What can you do to stop feeling guilty? "The most important thing," says Joyce Snyder a Beverly Hills psychologist, "is to be honest with yourself. Pushing guilt feelings even deeper into your unconscious only makes them that much harder to deal with. Instead, try to track your feelings to their source. Secondly, be kinder to yourself. Learn to appreciate your strong points. Build your self-esteem."

Take the time to analyse why you feel the way you do. Judith Davenport says : ask yourself, "Why do I feel guilty? Should I feel guilty?" In your childhood, did your parents use guilt as a way of controlling or punishing your behaviour?"

Remind yourself that "success" is not a dirty word. Only rarely is success achieved by being selfish or destructive or unethical. "You should begin," writes author Michael Korda, "by not feeling guilty about what is a natural and healthy ambition."

Learn to distinguish between appropriate and inappropriate guilt feelings. Guilt is appropriate, Willard Gaylin points out, when it warns us that we are failing our own ideals. "But one can feel sorry about something without feeling guilty." said the late psychiatrist Theodore Relk.

Try not to assume guilt where it does not realistically exist. "Men and women who advance over the heads of colleagues are often troubled by guilt," says Joyce Snyder, "but it is necessary to balance loyalty to others with loyalty to oneself."

Snyder tells of working mothers who burden themselves with guilt if their children get sick : "but lots of children with full-time mothers also fall ill, so why assume that your youngster has a cold or a fever because you're working?"

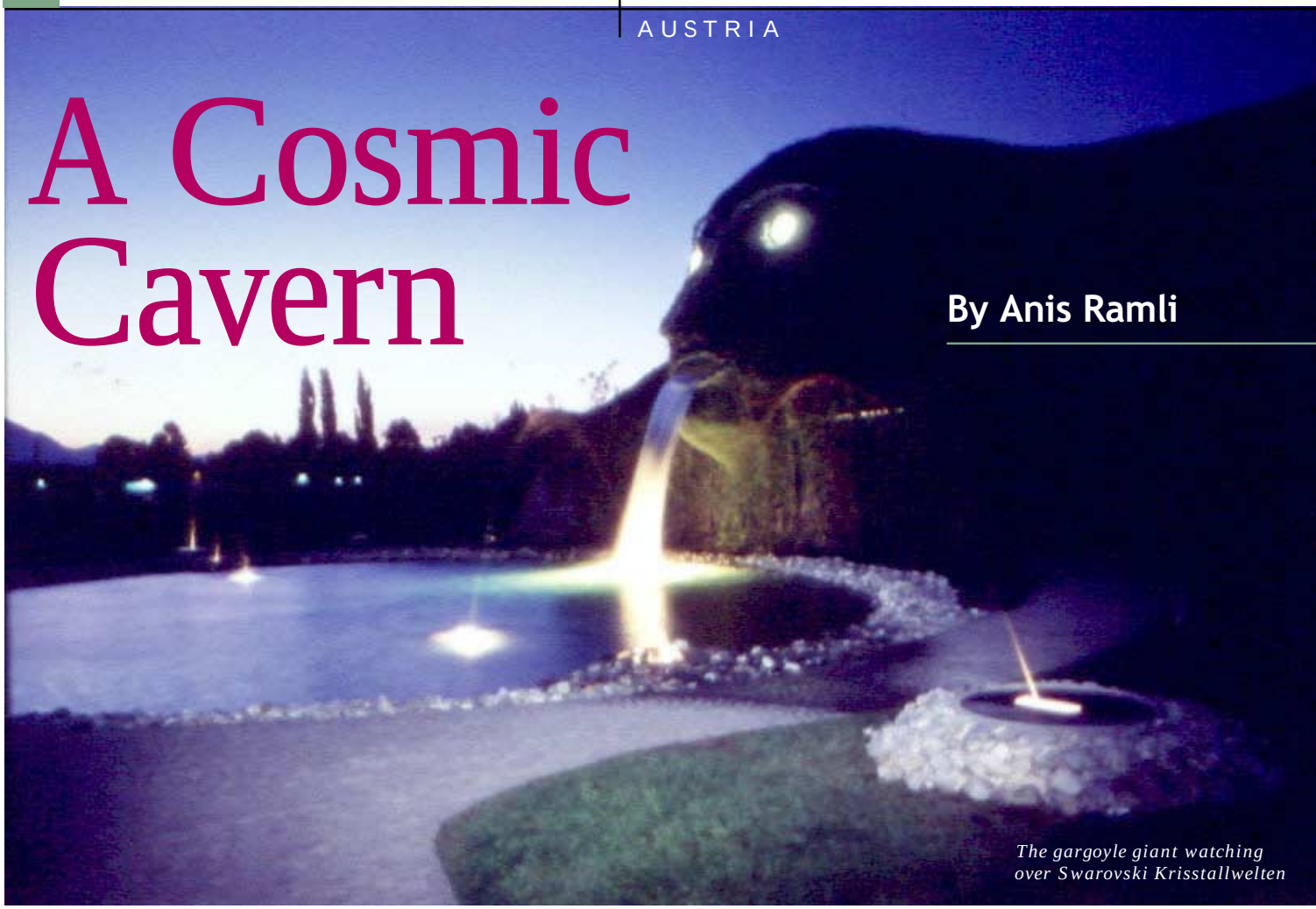
Take direct action to deal with guilt feelings when action is appropriate. "For instance, if what you have to do to be successful conflicts with your personal values, either quit that job or face the fact that success means more to you," Snyder says.

In another case, a man who was promoted over two colleagues — both of them his friends — went directly to them to explain that he had not sought the promotion and that more than ever he needed their advice and cooperation.

When guilt feelings are inappropriate or unrealistic — when they stem from unconscious reactions — talk about them with someone you trust. Getting your feelings out in the open with a friend, a mentor, or a spouse may be enough to strip them of their power. In some cases, however, it may be a good idea to seek professional help. AN

A Cosmic Cavern

By Anis Ramli



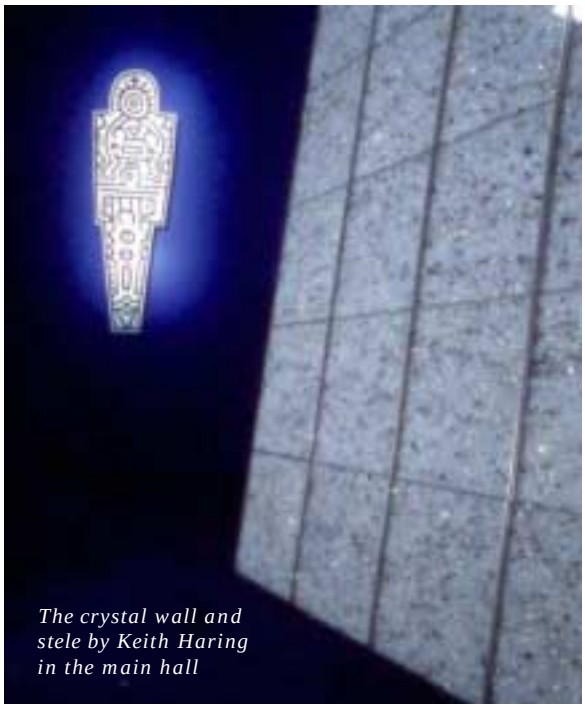
The gargoyle giant watching over Swarovski Krisstallwelten

Tucked in the valley of the Alps in Tyrol is the massive head belonging to an Alpine giant. A waterfall gushes out from its mouth to fall into the clear blue lake below while his crystal eyes glint from the sun above. In the summer, he wears the green colours of the fresh meadow and in winter, he turns icing-white — the waterfall transformed into a beard of ice. Depending on when your visit brings you to him, this is the first glimpse you'll get of Swarovski's Kristallwelten.

Kristallwelten, or Crystal World, is a mix of museum, fantasy and futuristic dreamworld. A labyrinth of six caverns inside the Giant's belly transports you to a world that borders around the whimsical and the bizarre. Colourful crystals combine art with music, razzmatazz with New Age, bringing a whole new spin to the world of crystals, as we know it.

Swarovski, of course, is the guru of fine cut crystals. It was founded in 1895 by Daniel Swarovski who invented, then patented a machine that could cut crystal stones with precision and consistency. Today, this renowned Austrian company is still a family-run business and is a leading manufacturer in full-cut crystal décor objects, accessories, jewellery stones, grinding and dressing tools, as well as optical precision tools. In 1995, the House marked its centennial existence by building Kristallwelten. But instead of building a monumental enclave that whizzes the visitor back and forth through the crystal or Swarovski's historical timeline, the family envisioned a unique masterpiece with crystal at its core.

Austrian master artist, Andre Heller, who also designed the Meteorit in Essen, Germany, was roped in for the project. In just 18 months, Heller brought his contemporary style to work, describing Kristallwelten as "a contemporary cham-



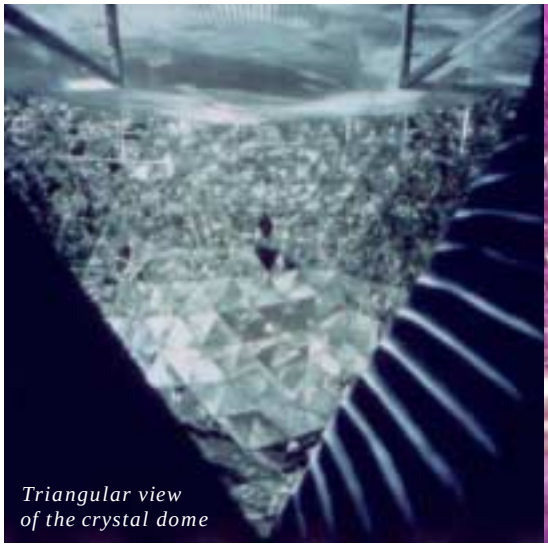
The crystal wall and stele by Keith Haring in the main hall

ber of wonders; a collection of rooms to astonish and amuse, rooms that would serve both as force fields and sources of inspiration for those with sensitivity to respond to them". Working together with Brian Eno (ex-Roxy Music), Susanne Schmogner and Studio Azzurro, to name a few, Heller successfully created a place where startling dimensions of crystals came to life with artistry and skills.

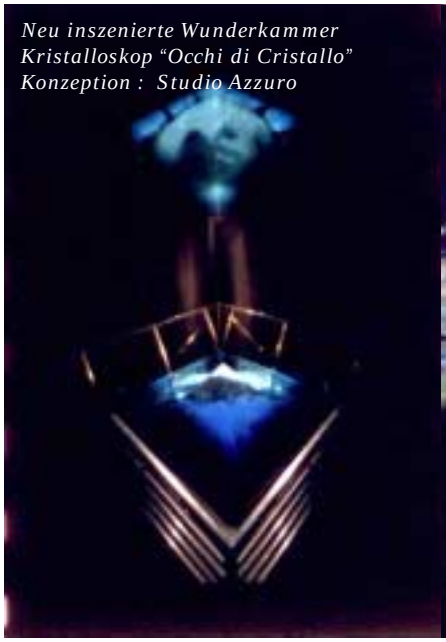
The Blue Entrance Hall

The first chamber in the Giant's belly greets visitors against a mystical blue backdrop which provides a striking background for the star of the room: a slanting crystal wall rising 11 meters high and packed with 12 tons of glittering coloured crystal stones. It is the architectural backbone of Kristallwelten and has the ability to draw the eyes to it as if by magic. In the foyer, the world's biggest crystal stone with 100 facets weighing 62 kilograms, and the smallest, a 0.8 mm stone that has to be seen through a microscope. On the walls are crystalline works by popular artists : Keith Haring's graffiti done as a stone slab in black cut-crystal stones; Salvador Dali's 'Melting Time' pendulum clock modelled in crystal; and a proud black stallion wearing a copy of the jewellery adornment made for the favourite horse of an Indian maharaja. The room is also host to Swarovski's 'Music in the Giant' concert series, where guests can enjoy some of Europe's finest music from the likes of Brahms or Chopin amid a totally new dimension.

Princess in the crystal dome



Triangular view of the crystal dome



Neu inszenierte Wunderkammer Kristalloskop "Occhi di Cristallo" Konzeption : Studio Azzuro

Courtesy 235 Media, Cologne.

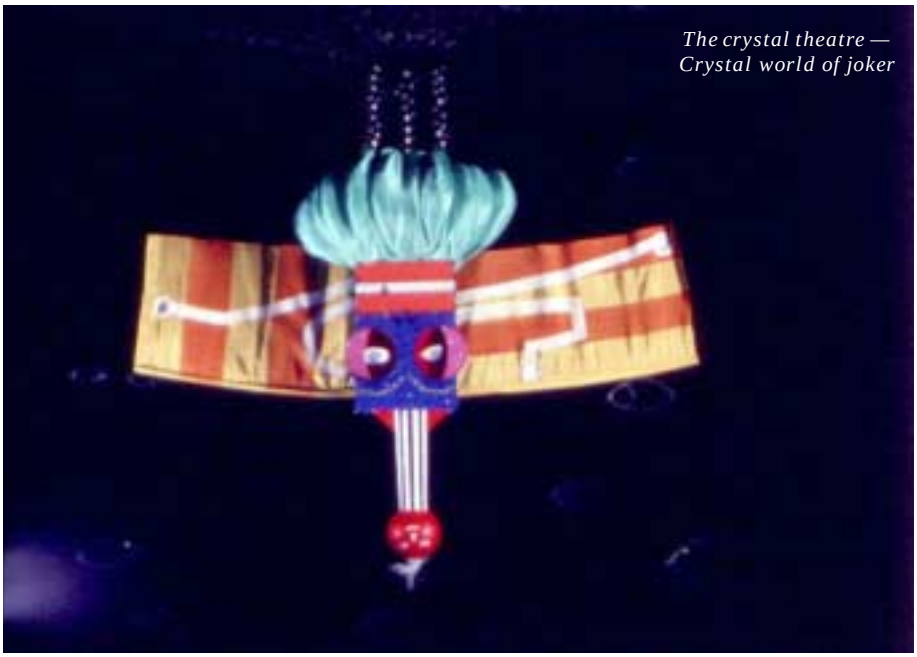
Un Passo di Cristallo Idea by Studio Azzuro

Courtesy 235 Media, Cologne.

View into the main hall, which contains the largest and smallest crystal stone in the world

The Planet of Crystals

This is touted as the world's first theatre room with three-dimensional projections that don't require any 3D technical aids. This mini-film begins with the planet's birth and ends with the emergence of crystals. The entire installation comes alive with a cosmic soundscape provided by German artists Roland Blum. With sparkling crystals in perpetual motion above and below, the room gives the observer the surrealistic impression of a walk through space.



The crystal theatre — Crystal world of joker

The Crystal Dome

The heart of Kristallwelten, the Dome's 590 mirrors, create the illusion of being inside a giant crystal. It resembles a glittering galaxy, and standing in the middle of the dome, lulled by Brian Eno's background tunes, one can actually feel its meditative powers. Eno, of course, is no stranger to music, having previously worked with various artists including U2 and David Bowie. The room's unique make and atmosphere also makes it popular as a venue for corporate cocktails, mini concerts and even wedding receptions.

Crystaloscope

The most bizarre room in Kristallwelten, the room is a reflection of the Giant's thoughts above. The changing images are both surreal and dreamlike, often open to interpretation. It is designed by Milan-based Studio Azzurro known for its artistic video production workshop and space-related video installations.

The Crystal Theater

The most colourful and interesting room among all the chambers, this resembles a mini Madame Tussaud's. There are figures decorated in crystal stones, a multi-coloured joker bedecked in more jewels, mottled crystals metamorphosing into lustrous butterflies. It's a poetic scenario with fairytale qualities full of colour and mystery. Walking away from the set lies a small section of Crystal Calligraphy — blown-glass tubes in letter-like shapes filled with colourful argon and neon gases on the inside. Below that, the 'ice passage', a pavement made of crystal cubes of 30 facets, with images changing each time the floor is touched. As more people move about, whatever is seen is dissolved only to come back in different shapes and colours.

Crystal calligraphy

The Eno Room

This chapel-like room provides the meditative conclusion to Kristallwelten. Brian Eno once again provided the musical background and designed the floating images across the screen to create this place of refuge. Featuring a cross section of pulsating light, sound and video objects, its meditative atmosphere is just the antidote for overcharged brain cells.

Apart from being a contemporary crystal 'museum', Kristallwelten's unique design offers immense possibilities for hosting various functions and is the ideal alternative environment for many events. Concerts, celebrations and fairytale evenings are just a few of the functions that find an incomparable setting in the sparkling ambience of the Giant. Besides the concert series, Kristallwelten will also be hosting the 'Fire-Dragon-Time' this December, an interactive fairytale festival that will bring the magic of Chinese mythology to this modern crystal subterranean.

GETTING THERE

Swarovski Kristallwelten is in Wattens, a 15-minute drive from Innsbruck, Austria. Open daily, 9am to 6pm, closed Christmas Day and New Year's. Admission 75 schillings. Groups of ten or more, 65 schillings per person. Free for children up to 12 accompanied by an adult and SCS members. Members also receive exclusive access to the VIP lounge and qualify for a discount on purchases in the large gift shop. Wheelchair-accessible. AN

Note : This trip was made possible by Lufthansa.

Annual Dialogue With the Ministry of Domestic Trade and Consumer Affairs

On 29 July 2001, the Chairman of the Insolvency and Company Law Practice Committee, Abdul Rahim Abdul Hamid and the secretary of the Committee attended the Annual Dialogue with the Ministry of Domestic Trade and Consumer Affairs held at the Regent Hotel, Kuala Lumpur. The Institute submitted a joint memorandum with the Malaysian Association of Certified Public Accountants (MACPA).

In line with the theme of the dialogue "The Way Forward For the Ministry In the New Millennium" the Institute proposed amendments be made to Sections 9(1)(c)(i) and 10(1)(c) of the Companies Act, 1965 so as to further reflect auditors' and liquidator's independence and objectivity in the performance of their duties.

Further to the above, the Institute also proposed an amendment to Section 9(4)(a) of the Companies Act, 1965 in view of eliminating the inconsistencies with Section 22 of the Accountants Act, 1967 in respect of non-resident partners of an audit firm in Malaysia.

The proposal is in view of the current provision of Section 9(4)(a) of the Companies Act, 1965 which appear to allow audit firms to have non-resident partners who are not approved company auditors registered in Malaysia under the Ministry of Finance. While, Section 22 of the Accountants Act, 1967 will only permit a person to act as an auditor (i.e. holding himself out as a public accountant) only if he (and his firm) is registered with the Malaysian Institute of Accountants and has his principal or only place of residence within Malaysia.

The Institute is of the view that the provisions of the two sections need to be aligned especially in view of the impending liberalisation of the accounting profession with our ASEAN counterparts in Year 2003. The proposed amendment is also timely to enable a more workable and practical set of Mutual Recognition Arrangement to be put in place in view of the liberalisation.

Other than proposals to amend the respective provisions of the Companies Act, 1965 the Institute and MACPA also proposed the implementation of the Code of Corporate Governance upon non-listed public limited companies and requested the Ministry to issue guidelines on the use of business names for registration with the ROB.

MACPA also made proposals on the issue of allowing auditors to form limited liability partnerships, on the setting up of a Business Advisory Services for Small and Medium Enterprises (SMEs), on the publication of a Guide on Doing Business in Malaysia and the issuance of guidelines on protection of consumer interest in e-commerce. AN

MIA Proposes Corporate Tax at 26 per cent to Spur New Investment Expenditure

The Malaysian Institute of Accountants (MIA) has proposed that the rate of corporate tax be reduced to 26 per cent from 28 per cent at present in order to spur new investment expenditure. The reduction would also enhance the country's competitiveness as a destination for international investments, a factor which is crucial today as countries are now competing for the limited pool of global funds or investments.

Reinvestment allowance should also be allowed to be claimed on a continuous basis, as long as the reinvestment is intended for the modernisation, expansion and/or diversification of plants and industries, MIA said in a memorandum submitted for the second day of the Budget 2002 dialogue on 13 July 2001.

During the dialogue session with the Prime Minister, Datuk Seri Dr. Mahathir Mohamad, who is chairing the session in his capacity as the Finance Minister in Putrajaya, the Institute also proposed that a double deduction in taxes be given to manufacturing companies based in Malaysia, in respect of the cost of approved knowledge-based value-added intermediate products consumed by relevant companies for inclusion in their final products, provided that these products are created, manufactured and supplied by an approved Malaysian intermediate products manufacturer.

MIA in its proposal to the Finance Minister, also recommended that a company be allowed a double deduction for expenses incurred in creating and maintaining its own corporate or business website with the condition that the website must be situated in Malaysia.

It added that a double deduction on the total cost of maintaining or creating a website would promote Malaysia-based companies to venture into electronic trade (e-trade) by launching individual websites and directly increase the level of participation of Malaysian companies on the Internet.

MIA also proposed a double deduction be given on the acquisition of patents, designs, models, plans, trademarks or brands and other similar rights by Malaysian resident companies.

Other proposals include the abolition of real property gains tax for properties held over 10 years, a double deduction on expenditure incurred by a company engaging a 'resident consultant' to review and improve a company's management and operational efficiency, the removal of the two-month bonus restriction introduced in 1998 and a reform of the sales and service tax system.

The Institute also proposed the revision of the chargeable income tax bands for individuals and/or capping the individual income tax rebate at 28 per cent. It further proposed a RM5,000 relief for individuals taking any course from a school or institution approved by the Ministry of Education, and also for anyone doing postgraduate studies.

In order to encourage Malaysians to keep abreast of the latest innovations in the computer world, MIA proposed that the RM400 rebate for the purchase of computers be revised once every three years instead of once every five years.

To view the complete document of MIA's submission during the Pre-Budget 2001 dialogue, which was presented on 13 July 2001, please log on to MIA's website. AN

Sarawak Focuses on Promoting Accountancy

The Sarawak Branch was kept busy with requests from secondary schools and institutions of higher learning to give talks on the accountancy profession and careers. The Education Committee visited institutions of higher learning, colleges and secondary schools in Kuching and other nearby towns of Kota Sentosa and Padawan. Committee member, Simon Tan, supported by Sarawak branch chairman, David Tiang and the education subcommittee members, Monica Wong and Richard Kiew, encouraged students to take up accountancy while Sarawak branch manager, Lucy Read, briefed students and teachers on the functions and role of the Institute. Some of the schools and colleges visited were Kolej Tun Abdul Razak, INTI College, FTMS, Swinburne Institute, SMB St. Joseph's, SMK Sungei Tapang and Kuching Polytechnic.

At the recent annual Chung Hua Middle School Education Fair, MIA was the only national body of professionals participating, together with more than 30 other institutions of higher learning from Singapore, Peninsula Malaysia and Australia. For two days MIA's simple table was constantly visited by students taking LCCI Accounting in these Chinese schools. Branch Manager, Lucy Read together with committee members Simon Tan and Thomas Law counselled students and parents on the different routes to become an accountant in Malaysia. What made the two days in the hot and humid conditions of the school hall cum badminton courts worthwhile was the appreciation we received from a very concerned uncle who intends to finance his very determined niece (from a less fortunate background) to take up accountancy and who was careful enough to ensure that she will get an education enabling her to be registered with MIA as an accountant in future. He related his experience of numerous unsuccessful and costly telephone calls to various bodies and institutions and how unconvinced he was with the replies to his queries. He was truly thankful for the 10 minutes of counselling given by MIA Sarawak. AN

A very grateful uncle listening to Thomas Law and Simon Tan at the Chung Hua Middle School Education Fair in Kuching

Form Five and Form Six students from Kolej Tun Abdul Razak in Padawan packed the school hall

Accounting Students from FTMS Kuching listening to the briefing by MIA Sarawak

Swing at Dawn, Run at Sunset, Bowl in the Dark

MIA golfers (L-R) ... N. K. Foo, Horace Ho, Zaini Aucasa, Michael Tong, George Bendusena, John Ho, Johnny Cham and Mojiun

Bowlers posing at the reception counter before entering into the dark lanes

Alexandra Thien handing over entry forms to co-ordinator, Marco Winter, witnessed by representatives of MIA's contingent at our office

MIA Tiger Wood hopefuls tee-ed off at early dawn against other professionals — lawyers, surveyors, engineers, architects, doctors, etc. There was no fretting or fussing under the unforgiving and merciless mid-day sun. The 2001 Inter-Professional Golf Tournament was organised by MIA member, George Bandusena at the Sabah Golf and Country Club in Kota Kinabalu. After the last score card was turned in and during the prize presentation ceremony, George made sure there was sufficient liquid replenishment. Lunch was appreciated by winners and losers alike along with the many prizes sponsored by all the participating bodies and other supportive individuals.

Seventy-seven organisations, including the MIA Sabah Branch, lent a helping hand (or legs) to the disabled by taking part in the Special Olympics 7 km sunset charity run which was flagged off by Kota Kinabalu Mayor, Datuk Abdul Ghani Rashid, at 5.07 p.m. The Bornean sunset provided the perfect backdrop for more than 4,000 participants, including 117 disabled children and adults, in Sabah's first mass sunset run. Alexandra Thien, MIA Sabah Branch Chairperson was extremely pleased with the encouraging response from more than 100 accountants and thanked them for helping Special Olympics Sabah.

However, for those who wished to maintain their porcelain complexion, away from the sun and spend some quality time with fellow accountants and colleagues, what more could they ask for but to bowl in the dark. For those who had never played or even heard of such an activity, they were be pleasantly surprised. The lanes at the Sutera Habour Club were in pitch darkness while ultra violet rays dramatised the ten pins and their teeth, of course. AN

IFAC Committee Approves New Standards and EDs

The International Federation of Accountants (IFAC) Public Sector Committee (PSC) has released four new International Public Sector Accounting Standards (IPSASs) and two new exposure drafts.

In their press statement dated 18 July 2001, IFAC stated that the IPSASs and exposure drafts are part of the PSC's ongoing project to develop a comprehensive body of international accounting standards for governments and other public sector entities around the world.

These IPSASs and exposure drafts are based on International Accounting Standards (IASs) issues at August 1997 to the extent that the provisions of the IASs are appropriate for application to the public sector. Titles of the IPSASs and the exposure drafts are as follows :

IPSAS 9 *Revenue from Exchange Transactions* establishes requirements for the accounting treatment of revenue from exchange transactions. Non-exchange revenue, such as taxation, is not addressed in this standard. Non-exchange revenue is to be dealt with as a separate project.

IPSAS 10 *Financial Reporting in Hyperinflationary Economies* describes characteristics of an economy that indicate whether it is experiencing a period of hyperinflation and provides guidance on restating the financial statements in a hyperinflationary environment to ensure useful information is provided.

IPSAS 11 *Construction Contracts* deal with both commercial and non-commercial contracts and provides guidance on the allocation of contract costs and, where applicable, contract revenue to the reporting periods in which construction work is performed.

IPSAS 12 *Inventories* establishes the accounting treatment of inventories held by public sector entities and deals with inventories held for sale in an exchange transaction and certain inventories held for distribution at no or nominal charge. The IPSAS excludes from its scope of work-in progress of services to be provided at no or nominal charge from recipients because they are not dealt with by IAS 2 Inventories and because they involve public sector specific issues which require further consideration.

ED 20 *Related Party Disclosures* is based on the International Accounting Standard (IAS) 24 — Related Party Disclosures. However, the ED explains that in the public sector the incidence and consequences of certain related party relationships and transactions differ from the private sector. Consequently, the ED includes additional guidance on the nature of related party relationships that arise in the public sector, the identity of key management personnel of public sector entities, and the information about related party relationships and transactions that should be disclosed for accountability purposes.

ED 21 *Provisions, Contingent Liabilities and Contingent Assets* is based on IAS 37, Provisions, Contingent Liabilities and Contingent Assets. IAS 37 does not deal with provisions and contingent liabilities arising from a range of "social benefits" that governments provide to constituents for no or nominal charge. Accounting for these "social benefits" raise a number of public sector specific issues, the resolution of which can have a significant impact of the financial statements of governments and their agencies. The ED proposes that this issue be dealt with as a separate public sector project. AN

Comments on the exposure drafts are to be submitted by 31 November 2001 by e-mail : EDComments@ifac.org or fax to the IFAC Secretariat, 1-212-286 9570.

The IPSASs and the exposure drafts are available on the IFAC website : www.ifac.org. Visitors to IFAC's website may also download International Public Sector Accounting Standards (IPSASs) 1-8, Study 11, *Governmental Financial Reporting : Accounting Issues and Practices*, and other recent exposure drafts issued by the PSC, including ED 9, *Financial Reporting Under the Cash Basis of Accounting*.

Auditor Independence

The International Federation of Accountants (IFAC) through its Ethics Committee had recently re-exposed the draft on Independence. In particular, the re-exposure draft clarifies certain points and describes additional specific circumstances that may create threats to independence and safeguards, that may be appropriate to reduce the threats to an acceptable level in each circumstance.

The re-exposure draft covers all assurance engagements. This would include an engagement in accordance with the "International Standard on Assurance Engagements" issued by the International Auditing Practices Committee (IAPC) or in accordance with specific standards for assurance engagements issued by IAPC such as, an audit or review of financial statements in accordance with the International Standards on Auditing.

The re-exposure draft also expands the class of people that may create threats to independence. That is to include individuals who are not part of the assurance team i.e., other partners and professional staff within the firm, and the firm itself.

This conceptual framework approach requires the identification and evaluation of threats to independence and the application of safeguards to reduce such threats, unless in certain circumstances the only possible course of action would be to resign or not to accept the assurance engagement. AN

FASB Completes Business Combinations Project

The Financial Accounting Standards Board (FASB) on 5 July 2001, concluded the voting process on its business combinations project after Board members submitted final ballots on 29 June.

Board members unanimously voted in favour of the two Statements : Statement No. 141, *Business Combinations,* and Statement No. 142, *Goodwill and Other Intangible Assets.* Both Statements will be published in July, and an announcement of their availability will be made through a press release and notice on the FASB website.

Those Statements will change the accounting for business combinations and goodwill in two significant ways.

First, Statement 141 requires that the purchase method of accounting be used for all business combinations initiated after 30 June 2001. Use of the pooling-of-interests method will be prohibited.

Second, Statement 142 changes the accounting for goodwill from an amortisation method to an impairment-only approach. Thus, amortisation of goodwill, including goodwill recorded in past business combinations, will cease upon adoption of that Statement, which for companies with calendar year ends, will be 1 January 2002. AN

FASB Issues Standard on Accounting for Asset Retirement Obligations

The Board of FASB at the end of June concluded deliberations and unanimously voted to issue Statement No. 143, *Accounting for Asset Retirement Obligations.* Initiated in 1994 as a project to account for the costs of nuclear decommissioning, the Board expanded the scope to include similar closure or removal-type costs in other industries that are incurred at any time during the life of an asset.

That standard requires entities to record the fair value of a liability for an asset retirement obligation in the period in which it is incurred. When the liability is initially recorded, the entity capitalises a cost by increasing the carrying amount of the related long-lived asset. Over time, the liability is accreted to its present value each period, and the capitalised cost is depreciated over the useful life of the related asset. Upon settlement of the liability, an entity either settles the obligation for its recorded amount or incurs a gain or loss upon settlement.

The standard is effective for fiscal years beginning after 15 June 2002, with earlier application encouraged. The Statement will be published in July, and an announcement of its availability will be made through a press release and notice on the FASB website. AN

FASB Proposal To Amend Accounting for Certain Costs and Activities Related to Property, Plant and Equipment

The Financial Accounting Standards Board (FASB) on 10 July, proposed to amend Statement No. 67, *Accounting for Costs and Initial Rental Operations of Real Estate Projects*, to exclude from its scope the accounting for acquisition, development and construction costs of real estate developed and used by an entity for subsequent rental activities.

According to the FASB statement made available to the Institute, the accounting for those costs would be subject to the guidance in an Exposure Draft of a proposed Statement of Position (SOP) issued by the Accounting Standards Executive Committee (AcSEC) of the American Institute of Certified Public Accountants. The FASB and AcSEC are jointly responsible for setting US accounting standards for level B of the hierarchy of generally accepted accounting principles.

The FASB's proposal also would amend APB Opinion No. 28, *Interim Financial Reporting,* to require that the costs that the proposed SOP would require, be expensed as incurred on an annual basis and also be expensed as incurred in interim periods.

AcSEC drafted the proposed SOP to address diversity in accounting for expenditures related to property, plant and equipment (PP&E), including improvements, replacements, betterments, additions, repairs and maintenance. The proposed SOP addresses accounting and disclosure issues related to determining which costs related to PP&E should be capitalised versus those that should be charged to expense as incurred. The proposed SOP also addresses capitalisation of indirect and overhead costs and component accounting for PP&E.

If adopted as a final Statement, the proposal would be effective for annual and interim financial statements for fiscal years beginning after 15 June 2002, with earlier adoption encouraged. The comment period ends 15 October 2001. The Exposure Drafts of the SOP and the FASB proposal are available free of charge on the FASB's website, www.fasb.org. AN

ASB Publishes Discussion Paper on Revenue Recognition

The recognition and measurement of revenue are of fundamental importance to proper financial reporting. Individual companies within the same sector can, at present, have different accounting policies, leading to marked variations in the timing of revenue recognition, and hence profit. Revenue recognition has been one of the concerns at the heart of the debate over aggressive earnings management.

There is at present no accounting standard in the UK and the Republic of Ireland that contains specific requirements for how revenue is to be defined and recognised. Faced with difficult questions over revenue recognition, different companies have found different answers, and practices have developed that are in some respects inconsistent from one industry to another and within a single industry.

Revenue Recognition, a discussion paper published recently by the Accounting Standards Board (ASB), is intended as a first step towards dealing with these problems. The Paper suggests that inconsistent revenue recognition practices are not merely a practical problem : they also reflect different views of what revenue should represent, and of how financial statements should portray a business's operating activities. Before attempting to deal with industry-specific issues, the ASB is seeking to establish a framework that can be used consistently to address revenue issues arising in different contexts.

The discussion paper examines revenue recognition and measurement from first principles, and considers fundamental questions :

- What should revenue represent?
- How should revenue recognition relate to contractual performance?
- How should incomplete contractual performance be accounted for?
- What impact should customer rights of return have?

The ASB is seeking respondents' views on the issues discussed and the proposals put forward in the paper. In particular, it is keen to receive comments on difficulties that may be encountered when applying the paper's proposals to specific industry issues, and examples illustrating particular revenue recognition issues that test the proposals set out in the paper.

Elaborating on this paper, ASB Chairman, Mary Keegan, said that "the issues surrounding revenue recognition arise in every country, and ASB proposals are intended to contribute to an international debate as well as setting a platform for further discussion about underlying principles."

"The ASB's aim is to develop a robust framework, in consultation with the International Accounting Standards Board and other standard-setters, that can ultimately be the basis for an accounting standard dealing with general revenue principles." AN

Revenue Recognition is available at £15.00 post-free from ASB Publications, P.O. Box 939, Central Milton Keynes, MK9 2HT, telephone 01-908-230344.

The Urgent Issues Group (IUG) meets with the Australian Accounting Standards Board (AASB)

The major items discussed at the Urgent Issues Group (UIG*) meeting on 14 June 2001 are outlined below. The UIG agreed to three new Consensus's, which are subject to veto by the Australian Accounting Standard Board (AASB). The AASB in their statement said that they are expecting to consider the Consensus's at their 27-28 June or 17 July meetings.

Subscriber Acquisition Costs (Telecommunications Industry) — *Consensus Agreed*

The consensus according to them require incremental direct costs incurred in obtaining subscribers to telecommunications services to be recognised as an asset only where the asset definition and recognition criteria (probability of future economic benefits and reliable measurement) are satisfied. Incremental direct costs are those costs which result directly from establishing specific subscriber contracts and would not have been incurred had those contracts not been entered into, such as sales commissions and the subsidised provision of telephones. All other costs are to be expensed, such as sales staff wages and salaries, occupancy costs and advertising. Capitalised subscriber acquisition costs are to be amortised over the period of expected benefit (for example, up to the contract period, where specified). Transitional provisions require acquisition costs inappropriately recognised previously as assets to be expensed. The consensus applies to reporting periods ending on or after 14 June 2001.

Recognition of University Operating Grants — *Consensus Agreed*

At the previous meeting, UIG members agreed that it would be very difficult to reach agreement in relation to the general issue of revenue or liability recognition for grants received, and sought to develop an Abstract in relation to university operating grants. A consensus has

now been reached that Commonwealth Government financial assistance payments to universities in respect of HECS-liable students are reciprocal transfers, as specific education services are agreed between universities and the Department of Employment, Training and Youth Affairs, with an acquittal process following the provision of the services. Accordingly, the consensus requires such financial assistance to be recognised as revenue in the reporting period in which the services are provided. Amounts received by universities in advance of the services being provided therefore would be recognised initially as liabilities. The consensus applies to reporting periods ending on or after 14 June 2001.

Tax Consolidation Proposals and Deferred Tax Balances — Consensus Agreed

The UIG reached a consensus that the draft tax consolidation legislation should be taken into account in determining deferred tax balances only once it has been enacted or substantively enacted, and is relevant to the entity (the proposed tax consolidation system is elective rather than compulsory). This approach is applicable irrespective of whether an entity is applying the income tax accounting standards issued in 1989 (currently operative) or the 1999 revised standards (mandatory for reporting periods beginning on or after 1 July 2002). The consensus states that substantive enactment should be taken to have occurred in this case when proposed legislation has been tabled in Parliament and there is majority support for its passage. The consensus applies to reporting periods ending on or after 14 June 2001.

Intra-group Non-Reciprocal Transfers for Monetary Consideration

The UIG continued its discussion of the accounting by acquirers for assets purchased from other entities in the same economic entity for monetary consideration through non-reciprocal transfers or transfers with non-reciprocal components. Members agreed that such a transfer should be recognised at the fair value of the transfer. They also agreed that the difference between the fair value of the transfer and the amount of the consideration should be recognised by the acquirer as revenue, unless the definition of "contribution by owners" was satisfied, in accordance with Accounting Standards AASB 1004 and AAS 15 *Revenue*. Transitional provisions will propose initial adjustments, where practicable. A consensus is expected to be reached at the next meeting.

Fair Value of Equity Instruments Issued as Purchase Consideration

The UIG recommenced its discussion of this topic, as the issuance of a Draft Interpretation on the topic by the Standing Interpretations Committee of the International Accounting Standards Board was no longer expected. UIG members noted that Accounting Standards AASB 1015 and AAS 21 *Acquisitions of Assets* state that in some instances the price at which marketable securities could be placed in the market is a better indicator of fair value than their market price. Members therefore agreed to consider various factors that may affect the measurement of the fair value of equity instruments issued as purchase consideration, such as escrow provisions, impending listing of the instruments on an exchange, and block premiums or discounts.

Classification of Resetting Preference Shares

The UIG commenced its discussion on the classification of preference shares with features such as the resetting of dividend rights at five-year intervals, and the shareholders and issuers both having various rights at reset dates. For example, the holders may be able to convert the preference shares into ordinary shares at a discount or sell the preference shares to a nominated third party. The issuer may also have the right to convert the preference shares into ordinary shares. No decisions were made, and the topic will be discussed again at the next meeting. AN

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- The Urgent Issues Group (UIG) is a committee of the Australian Accounting Standards Board (AASB) established in conjunction with the Financial Reporting Council (FRC). The UIG comprises 16 members who are senior members of the financial reporting community representing the interests of preparers, auditors and users in the private and public sectors. The Australian Securities & Investments Commission (ASIC) Chief Accountant joins meetings of the UIG as an observer. The Australian accounting profession's representative on the Standing Interpretations Committee of the International Accounting Standards Board is also an observer.
- The UIG's role is to review on a timely basis financial reporting issues that are likely to receive divergent or unacceptable treatment in the absence of authoritative guidance. The objective of the UIG is to reach a Consensus on the appropriate accounting treatment. The UIG cannot reach a Consensus that changes or conflicts with existing Accounting Standards and Statements of Accounting Concepts.
- Meetings of the UIG are held in public. The minutes of UIG meetings and UIG issue papers, including Issue Summaries and draft Abstracts, are public documents. They can be purchased from the Australian Accounting Standards Board. Issue Summaries, Issues Papers and draft Abstracts are published before each UIG meeting for discussion purposes only. A proposed UIG Consensus included in a draft Abstract will not have been subject to a formal vote and, therefore, is not an authoritative ruling.
- To reach a Consensus on an issue, at least eleven members must vote in favour of, and no more than three vote against, the proposed Consensus. UIG Consensus views are published in the form of a UIG Abstract.
- The AASB has a reserve power of veto over UIG Consensus views. That veto must be exercised within 21 days of the Board being informed of the UIG's Consensus view.
- UIG Consensus views are mandatory for members of The Institute of Chartered Accountants in Australia (ICAA) and CPA Australia, and as such must be consistently applied in the preparation and presentation of general-purpose financial reports. UIG Consensus views may also be given authority by other legislative or regulatory bodies, such as ASIC.

IASB's Standing Interpretations Committee (SIC) Issues Five Draft Interpretations

The Standing Interpretations Committee (SIC) on 7 July 2001, published five Draft Interpretations to clarify the approach to certain issues under International Accounting Standards (IAS). The Draft Interpretations are available both in hard copy format and also on IASB's website, http://www.iasb.org.uk. Comments should be submitted in writing by 10 September 2001. The Draft Interpretations are :

- **SIC – D28** : *Business Combinations — Measurement of Shares Issued as Purchase Consideration;*
- **SIC – D29** : *Disclosure — Service Concession Arrangements;*
- **SIC – D30** : *Reporting Currency — Translation from Measurement Currency to Presentation Currency;*
- **SIC – D31** : *Revenue — Barter Transactions Involving Advertising Services*; and
- **SIC – D32** : *Intangible Assets — Web Site Costs.*

Commenting on the new Draft Interpretations, Paul Cherry, Chairman of the Standing Interpretations Committee, said that the release of these Draft Interpretations temporarily concludes their discussion of these items. It is now time to listen to our constituents. The consensus reached in SIC-D28 is particularly important, because the date of measuring shares issued in an acquisition can have a dramatic effect on the cost of the acquisition. The Draft Interpretation clarifies that in a single step acquisition the shares issued should be measured at the date when the acquirer obtains control over the operations of the acquiree.

Paul also said that the disclosure of the terms of service concession arrangements is necessary to gain a full understanding of their effect on an enterprise's financial position, financial performance and cash flows. These arrangements often involve major infrastructure assets and the services provided may make up the entire operation of an enterprise. As regards the Draft Interpretation on reporting currency, this follows on from SIC-19 and specifies the method for translating financial statements from a measurement currency to a presentation currency. The consensus relating to barter transactions imposes a number of conditions that are necessary before revenue in certain barter transactions involving advertising can be considered reliably measured. While the scope of the issue has not been explicitly expanded to cover all barter transactions, the consensus should serve as useful guidance in other circumstances. We have also issued a Draft Interpretation to assist enterprises in accounting for the costs to develop their own web site. The Appendix provides useful examples of the types of expenditures incurred in each of the stages of development.

Printed copies of Draft Interpretations SIC-D28, SIC-D29, SIC-D30, SIC-D31, and SIC-D32 will be mailed to subscribers to IASB's "SIC Interpretations Subscription Package" and to subscribers to the IASB "Comprehensive Package"

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- **SIC – D28** : *Business Combinations — Measurement of Shares Issued as Purchase Consideration*

The Draft Interpretation addresses when the "date of exchange" occurs where shares are issued as purchase consideration in an acquisition. The SIC agreed that when an acquisition is achieved in one exchange transaction, the "date of exchange" should be the date of acquisition; that is, the date when the acquirer obtains control over the net assets and operations of the acquiree. When an acquisition is achieved in stages (e.g., successive share purchases), the fair value of the shares issued as purchase consideration should be determined at the date that each exchange is recognised.

The Draft Interpretation also addresses when it is appropriate to use a price other than a published price at the date of exchange when determining the fair value of an acquirer's shares that are quoted in an active market. The SIC agreed that the published price of a share in an active market at the date of exchange should be considered the best evidence of the share's fair value. Another price should be used only if it can be demonstrated that a price fluctuation is undue, and the other price provides a more reliable measure of the share's fair value.

- **SIC – D29** : *Disclosure — Service Concession Arrangements*

The Draft Interpretation addresses what information should be disclosed in the notes to the financial statements of a Concession Operator and a Concession Provider when the two parties are joined by a service concession arrangement. A service concession arrangement exists when an enterprise (the Concession Operator) agrees with another enterprise (the Concession Provider) to provide services that are normally considered public services. Examples of service concession arrangements involve water treatment and supply facilities, motorways, car parks, tunnels, bridges, airports and telecommunication networks. Examples of arrangements that are not service concession arrangements include an enterprise outsourcing the operations of its internal services (e.g., employee cafeteria and accounting or information technology functions). The SIC agreed that the following should be disclosed in each period :

- a description of the arrangement;
- significant terms of the arrangement that may affect the amount, timing and certainty of future cash flows (e.g., the period of the concession, contractual re-pricing dates and the basis upon which re-pricing or re-negotiation is determined);
- the nature and extent (e.g., quantity, time period or amount as appropriate) of :

1. transferred rights to use specified assets;
2. obligations to provide or rights to expect provision of services;

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3. obligations to acquire or build items of property, plant and equipment;
4. obligations to deliver or rights to receive specified assets at the end of the concession period;
5. renewal options;
6. other rights and obligations (e.g., major overhauls); and

- changes in the arrangement occurring during the period.

■ **SIC – D30** : *Reporting Currency — Translation from Measurement Currency to Presentation Currency*

This Draft Interpretation addresses how an enterprise should translate its financial statements from a currency used for measuring items in its financial statements (measurement currency) to another currency for presentation purposes (presentation currency). SIC-19, Reporting Currency — Measurement and Presentation of Financial Statements Under IAS 21 and IAS 29, requires that the translation method used not lead to reporting in a manner that is inconsistent with the measurement of items in the financial statements. The SIC agreed that the requirements of SIC-19.9 should be applied as follows :

- assets and liabilities should be translated at the closing rate existing at the date of each balance sheet presented, except when an enterprise's measurement currency is the currency of a hyperinflationary economy, in which case assets and liabilities should be translated at the closing rate existing at the date of the most recent balance sheet presented;
- income and expense items should be translated at the exchange rates existing at the dates of the transactions or a rate that approximates the actual exchange rates, except when an enterprise's measurement currency is the currency of a hyperinflationary economy, in which case income and expense items for all periods presented should be translated at the closing rate existing at the end of the most recent period presented; and
- all resulting exchange differences should be classified as equity.

The Draft Interpretation also addresses what information should be disclosed when additional information not required by International Accounting Standards is displayed in a currency, other than the currency used in presenting its financial statements, as a convenience to certain users. The SIC agreed that in this circumstance an enterprise should :

- clearly identify the information as supplementary information to distinguish it from the information required by International Accounting Standards; and
- disclose the method of translation used as a basis for presenting the information.

■ SIC – D31 : *Revenue — Barter Transactions Involving Advertising Services*

The Draft Interpretation addresses how revenue from a barter transaction involving advertising should be measured, and the circumstances when the fair value of advertising services received or provided in a barter transaction be reliably measured. The SIC agreed that :

- an enterprise providing advertising should measure revenue from a barter transaction based on the fair value of the advertising services it receives from its customer unless it is impracticable to measure reliably, in which case the enterprise should use the fair value of the advertising services it provides to the customer. If the fair value of the advertising services of both enterprises is not reliably measurable, the Seller should recognise revenue only to the extent of the carrying amount of assets given up.
- the fair value of advertising services received or provided in a barter transaction can be reliably measured only by reference to non-barter transactions that :

1. involve advertising similar to the advertising in the barter transaction;
2. occur frequently;
3. are expected to continue occurring after the barter transaction;
4. represent a predominant source of revenue from advertising similar to the advertising in the barter transaction;
5. involve cash and/or another form of consideration (e.g., marketable securities, non-monetary assets, and other services) that has a reliably measurable fair value; and
6. do not involve the same counterparty as in the barter transaction.

■ **SIC – D32** : *Intangible Assets — Website Costs*

The Draft Interpretation addresses the accounting for an internal expenditure on the development, enhancement and maintenance of a web site by an enterprise for its own use. Specifically, it addresses whether the website is an internally generated intangible asset that is subject to the requirements of IAS 38; and whether the purpose(s) of the website might impair the enterprise's ability to demonstrate how the web site will generate probable future economic benefits under IAS 38.45(d).

The SIC agreed that a website developed by an enterprise for its own use is an internally generated intangible asset that is subject to the requirements of IAS 38. It also agreed that :

- the Planning stage is similar in nature to the research phase in IAS 38.42-.44, and therefore an expenditure incurred in this stage should be recognised as an expense when it is incurred;
- the Application and Infrastructure Development and Graphical Design and Content Development stages are similar in nature to the development phase in IAS 38.45-.52. Therefore, expenditures incurred in these stages should be recognised as an intangible asset if, and only if, in addition to complying with the general requirements for recognition and initial measurement of an intangible asset, an enterprise can demonstrate those items described in IAS 38.45. In addition,

1. an enterprise may be able to demonstrate how its website will generate probable future economic benefits under IAS 38.45(d) by using the principles in IAS 36, Impairment of Assets. This includes situations where the website is developed solely or primarily for promoting and advertising an enterprise's own products and services; and
2. an enterprise may incur an expenditure to enable use of content, which had been purchased or created for another purpose, on its website (e.g., acquiring a license to reproduce information) or may purchase or create content specifically for use on its website prior to the website becoming available for use. In such circumstances, an enterprise should determine whether a separate asset is identifiable with respect to such content (e.g., copyrights and licenses), and if a separate asset is not identifiable, then the expenditure should be included in the cost of developing the website when the expenditure meets the conditions in IAS 38.54.
3. the Operating stage commences once the website is available for use, and therefore an expenditure to maintain or enhance the website after development has been completed should be recognised as an expense when it is incurred unless it meets the criteria in IAS 38.60.

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SELF-ASSESSMENT NEED NOT BE AN UNPLEASANT TASK

MALAYSIAN ASSOCIATION OF ACCOUNTING ADMINISTRATORS

Incorporation and Aim

The Malaysian Association of Accounting Administrators (MAAA) was incorporated in 1990 with limited liability under Section 16(4) of the Companies Act, 1965 in recognition of the two-tiered nature of the accountancy profession. MAAA (previously known as Malaysian Association of Accounting Technicians) is a company sponsored by the Malaysian Institute of Accountants (MIA).

Main Objectives

- To provide a qualification to be known as Accounting Technicians/Administrators for persons employed on duties customarily undertaken by assistants to accountants registered with the MIA.
- To provide an organisation and membership for such persons who are desirous of acquiring such qualification and persons who are granted such qualification.
- To promote in the public interest the technical competence of such persons engaged in positions and performing the functions of accounting technicians/administrators.

Council Members (2001 Term)

Elected Members

Izhar Abd Kahar *(President)*
Koo Yew Fook, Allan *(Vice President)*
Chin Wah Yin
Hanapi Rasol
Kasim Darus
Lim Ah Leck
Low Han Men, Aric
Mahadevan s/o Gengadaram
Mok Kam Seng
Panneer Selvam
YM Raja Noorhana bt Raja Harun
Yong Yoon Kee

MIA Nominated Members

YB Dato' Lee Hwa Beng
Assoc. Prof Dr. S. Susela Devi

Secretariat Office

Malaysian Association of Accounting Administrators
Dewan Akauntan, 2 Jalan Tun Sambanthan 3, Brickfields, 50470 Kuala Lumpur.
Tel : 03-2274 5055 or Fax : 03-2274 1783
e-mail : maaa@mia.org.my

Editor for MAAA News : Low Han Men, Aric

Report by Panneer Selvam & Thane Meyyappan

Have you completed your tax forms? Do you have problems completing your tax forms? For those who attended the Evening Talk on 15 June 2001, all the perceived problems associated with the soon to be implemented SELF-ASSESSMENT would have been solved. This was MAAA's 6th Evening Talk on the hot topic : "Self-Assessment-Malaysian Tax System, Changes & Implications to the Tax Payer" presented by P. Ganesan.

Ganesan, the current Deputy Director of the National Tax Academy was certainly an authority on tax matters as he enlightened participants on the important issues, implications and the serious views the Inland Revenue Board takes on changes to the new approach in tax submission that is taking place in stages presently. These changes affect companies, partnerships, sole-proprietorships and individuals as well.

All the participants were kept deeply interested in the many issues discussed on Self-Assessment so much so that the talk extended beyond the usual one and a half hour talk to a two and a half hour talk. Ganesan explained that Self-Assessment is a system whereby taxpayers are required by law to determine their taxable income, compute tax liability and make payments when submitting their tax returns.

Self-Assessment generally involves four areas — Submission of Returns, Assessments, Payments and Offences.

Submission of returns

- Tax return is required to be submitted to the Director-General's (DG) office within six months from the date a company closes its accounts.
- The return must specify the chargeable income and amount of tax payable and other required particulars.

Assessment

- A return is deemed to have been made an assessment by the DG on the day of submission and the return is also deemed to be a notice of assessment to be served on the company.
- An appeal must be made within 30 days from the deemed assessment date otherwise it is deemed to be final and conclusive.

Payments

- Tax must be made payable within six months from the end of the basis year of the company.
- Companies under instalment payments are required to provide estimates at least 30 days before commencement of the relevant basis year and it should be payable on the 10th of the second month.

- Revision of instalment scheme is only permitted once at the end of the sixth month.
- If there is a difference between the assessed and instalment scheme of more than 30 per cent, a penalty of 10 per cent would be imposed on the difference.

Offences

- Non-compliance of submission of tax return.
- Person who assists or advises with respect to the preparation of a return which results in an understatement of another person's tax liability (unless reasonable care is proven) can incur a minimum fine of RM2,000 to a maximum fine of RM20,000 or imprisonment for a term not more than three years or both.
- Section 80 (1A) of the Income Tax (Amendment) (No.2) Act 1999 states that a DG or an authorised officer who enters any land, building or place shall be provided with all reasonable facilities and assistance. Failure to do so is an offence.

The talk was attended by about 50 participants (members and Non-members of the Association) who posed many questions to the speaker. More information may be obtained from :

The audience in deep concentration as they digest the many pointers on 'self assessment'

Website : http://www.hasilNet.org.my
e-mail : lhdn@hasilNet.org.my e-mail : apn@po.jaring.my
e-mail : plwong@hasilNet.org.my (Tel : 03-6515613)

Technical Division — Tel : 03-6201 0066/6201 7055 Fax : 03-6201 0905
Operations Division — Tel : 03-6201 0066/6201 7055 Fax : 03-6201 8891
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LEGAL/ACCOUNTING

MEDIATION AN ALTERNATIVE TO ARBITRATION AND LITIGATION

By Yong Yung Choy ADVOCATE & SOLICITOR

Early this year, the Public Practice & Tax Committee decided to seriously look into the possibility of incorporating the mediation process in the Institute's investigation & disciplinary proceedings at the onset, in order to reduce many disputes that are presently being handled by the Investigation & Disciplinary Committees.

However, any intended legal reform in this area will take its due process. In the meantime, there are complainants who have unrealistic expectations when lodging their complaints with the Institute. The Institute is thus hopeful that, where there are disputes between members not involving allegations of unprofessional conduct, members can take advantage of an existing mediation service offered by the Bar Council where, possibly, a more palatable solution for all parties can be arrived at. This column may therefore be of interest to members.

What is the Meaning of Mediation?

Mediation is a process of solving a dispute between parties by a third party. The third party acts in a manner to facilitate a settlement between the disputing parties and he is called a mediator.[1] The mediator does not make a decision on behalf of the parties nor does he impose a decision upon the parties like an arbitrator or a judge of the court.[2] The decision is a joint decision made by the parties and that means that the parties are in consensus in that decision and is described as facilitative mediation. The Oxford dictionary defines mediate as "*form connecting link between; intervene between two persons for the purpose of reconciling them; be a medium for bringing about results.*" At present there is no legal definition for mediation or a legal structure under a statute like arbitration

1 (a) "Mediation — Charting the Right Course for the New Millennium", by Rajah Chandran (1999), 3 C.L.J. p. xiv;
(b) "Mediation & ADR Development in the Various Jurisdictions. Have the Lawyers Caught On?", by Vinayak P Pradhan, p. 5, a paper presented during the 12th Commonwealth Law Conference.

2 "Mediation & ADR Development in the Various Jurisdictions. Have the Lawyers Caught On?", by Cecil Abraham, Insaf Vol. xxiv, No. 1, p. 67.

under the Arbitration Act, 1952, where there are prescribed provisions behind it. Mediation is also unlike litigation where powers and procedures are prescribed under the Court of Judicature Act, 1964, and the Subordinate Act, 1948, together with the Rules made thereunder.[3] The word 'mediation' is also used differently in other[4] ways by different parties like 'mediation' under the insurance bureau which has prescribed its own meaning behind it and its own process which is different from facilitative mediation. In the jurisdictions of New South Wales, Australia and New Zealand when they practise mediation, they refer to the definition of facilitative mediation.[5] For our purpose of discussion, we shall discuss facilitative mediation which is a process of solving disputes between parties by a mediator resulting in a consensus decision.

The Principle Behind Mediation

The basic principle behind this process of mediation is that the power to resolve or come to any decision rests in the hands of the parties and not in the hands of the mediator unlike an arbitrator or a judge who makes an award or a judgement. The parties will decide whether they will come to terms with themselves; in particular whether they are happy with the terms that they have achieved. The mediator cannot impose his terms on the parties; insisting that his opinion or his views or his decision must be accepted by the parties and even to the extent that the mediator may feel strongly against the parties' decision. The disputing parties are in control of their decision or resolution, not the mediator. Thus lies the difference between the arbitration award and the mediation decision (parties agreed decision) or between the judgment and mediation decision (parties agreed decision). In an arbitration, the arbitrator makes an award after hearing the submissions of the parties on his own and he has the full say in that decision. Subject to the provisions of the Arbitration Act, 1958, the award of the arbitrator is final. The situation is the same in the litigation process where judgement is final, subject to the appeals allowed under the Court of Judicature Act 1964 and the Subordinate Act 1948.

The Procedure in Mediation

The procedure for mediation[6] is very different from arbitration and litigation. It is simple and flexible and can be varied according to the needs of the parties, if required under the circumstances. It is also suppose to be transparent for all the parties to see that there is no hidden agenda set by the parties or the mediator. If there is anything that the mediator has to disclose to the parties he must do so like possible conflicts of interest; possible bias and any other unethical things. The proceedings will be private as distinguished from public proceedings like litigation proceedings in the courts and can be held in any place that is convenient to the parties: The proceedings is conducted in a confidential manner. What is said or done by the parties cannot be disclosed to the other party or to a third party without the consent of the other party or both parties. If certain information is disclosed to the mediator on a confidential basis, then this information cannot be disclosed to the other party or to any party subject to law and the consent of the other party. This confidence must be upheld at all times even if the disclosure will help the settlement of the case. At the end of it all the parties must be satisfied with the proceedings of mediation because they have every right to call off the proceedings at any time and that is the extent of their control of the mediation process. The mediation procedure is very different from arbitration and litigation, which have many rules and procedures to follow during the process where the dispute is been resolved by the parties.

In arbitration there are strict procedure requirements for the parties to follow under the Arbitration Act, 1958, e.g. the taking of oaths by the parties in giving evidence. When there is an arbitration clause in the contract the parties must go for arbitration.[7] The litigation process also has a lot of rules and regulations governing it like the Rules of the High Court 1980, Rules of the Federal Court 1995, Rules of the Court of Appeal 1994, Rules of the Subordinate Court 1955 and other rules.[8] Failure to follow the rules may result in a variety of consequences like paying of costs to the other party or being struck out from the courts. In fact the procedural requirements of litigation are stricter than the procedural requirements of arbitration. There is no such similar consequence for not complying with the procedure of mediation.

(a) The mediator's opening statement

At the beginning of the proceedings the mediator will address the disputing parties. He will introduce himself to them and he will explain the mediation procedure to them. The few basic concepts of mediation will be highlighted, like that the proceedings are private and confidential and that their decision will be voluntary and the consensus will be introduced at this stage for the parties to understand the nature of mediation. A few ground rules like giving each party an equal chance to speak without interruption from the other and that common courtesy to each other should be maintained at all times will be explained to them. At this stage the authority to negotiate and conclude an agreement by the parties present will be established by the mediator. If there is no authority by one of the parties, the other party may not want to

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3 Rules of the High Court 1980, Rules of the Federal Court 1995, Rules of the Court of Appeal 1994 and Subordinate Court Rules 1980, in addition, there other rules provided for under various statutes.

4 (a) "Mediation & ADR Development in the Various Jurisdictions. Have the Lawyers Caught On?", by Cecil Abraham, Insaf Vol. 1, pp. 74-75.
(b) "Mediation — Charting the Right Course for the New Millennium", by Rajah Chandran (1999), 3 C. L. J. p. xxiii, describes the various types of mediation.

5 (a) Accord Group Australia teaches mediation using facilitative mediation.
(b) LEADR both of Australia and New Zealand also teach facilitative mediation.
(c) Singapore Mediation Centre also practices facilitative mediation.

6 "Mediation & ADR Development in the Various Jurisdictions. Have the Lawyers Caught On?", by Vinayak P Pradhan, a paper presented during the 12th Commonwealth Law Conference p. 5.

7 Arbitration Act, 1952, s.6.

8 Certain statutes provide for their own procedure like the Probate and Administration Act, 1959; Law Reform (Marriage and Divorce) Act, 1976; Company Winding Up Rules, 1972, etc.

proceed with the mediation. The mediator must try to make the atmosphere as calm and comfortable as possible to encourage both parties to talk to each other, i.e. to build communication lines between them.

(b) The joint session of the hearing

Then the proceedings start with the parties stating their cases on paper given to the mediator or making oral submissions before the mediator and this is up to the parties. Either party can start his case first with the permission of the other party. This is sometimes called the joint hearing because the first party will state his case as he sees it in the presence of the other party. Then the other party will be given an equal opportunity to state his case or his denial of the opposing claims or even the justification of his conduct to the other side. Maximum latitude is given to the parties to say anything that they want even to the extent that what is stated is irrelevant or inadmissible in a court of law subject to the common courtesy and limits of the law. Unlike the courts, there is no place for arguments in the area of relevance of the facts or the admissibility of the evidence as this is not the forum for such an application. After hearing the two submissions, the mediator will try to summarise the dispute between the two parties bearing in mind that he should scale down the conflict as much as possible including the use of neutral terms as much as possible to describe the conflict and list the issues for discussion. At this stage of the hearing the atmosphere is normally tense and the parties are emotional over the dispute. This is the understanding phase of the problem by the mediator.

(c) The single session of the hearing

The second stage of the proceedings is the single session whereby the mediator meets one party at a time in a private session, sometimes called the caucus session. The purpose is to encourage the party to speak freely without the presence of the other party. With this private single session the parties are more likely to speak the truth or reveal the real cause of the conflict between the parties. Additional knowledge of the dispute or hidden agendas or the real issues or conflicts will help the mediator in analysing the dispute and facilitating the resolution of the dispute. Equal time and opportunity will be given to the other party to do the same thing. At this stage the mediator will encourage the party to propose options for solving the dispute and if necessary, help the party to asses his own options in terms of acceptability by the other party. If the proposals are unrealistic then the mediator may have to test the viability of the options very carefully without making the party feel the pressure or become a form of cross examination. It is also the time for specific discussion and analysis. Then the proceedings start with the parties stating the details of the proposals. The mediator must tread very carefully in the area of impartiality and confidentiality lest he may be accused of taking one side. Concerns of the other party will be addressed in the private single session to see the reaction of this party in session. There is no limit as to the number of times for a caucus session and it can be as many times as is necessary under the circumstances.

(d) The subsequent joint session of the hearing

The mediator will resume a joint session after the single session. In this session he will state the old issues or new issues that have arisen and he will encourage the parties to discuss them openly and to help them to identify their common interests which will encourage them to build a relationship rather than destroy it.[9] With this background the parties are encouraged to create options[10] to overcome their problems and sometimes the parties may have to have a brainstorming session to seek the right options for a final resolution of their dispute. If requested, the mediator may suggest ideas for consideration by the parties so as to help along the parties. If the expectations of the parties are too high, the mediator may suggest that they do some reality testing to see whether such objects are attainable outside mediation. Sometimes the mediator will encourage the party to compare with what they can possibly achieve outside the mediation and this process is sometimes called BATNA or Better Alternative To Negotiated Agreement.[11] The mediator may even suggest that they obtain independent advice from some expert to overcome technical issues. Hopefully this session will lead to a settlement between the parties. Normally at this stage the parties are ready to consider settlement of their dispute.

(e) The end of the session of the hearing

Once all the issues are ironed out by the parties, and both sides are willing to settle the dispute, the mediator will record all the terms of the dispute in a contract immediately. While the pressure to achieve an agreement is on, the mediator will try to make sure that the agreement can be carried out by the parties. He will try to go through the agreement with the parties to avoid this problem. The contract will be signed, stamped and delivered to the parties. If the mediation has taken place pending trial, then the agreement between the parties can be recorded as consent judgement in court. If the agreement between the parties is recorded as consent judgement in the court, then the parties can enforce the judgement in the court if one of the parties defaults in the compliance of it. Since the parties have put in so much effort in the settlement of their dispute, they are unlikely to break their contract[12]. If there is any need to enforce the contract it can be done in the courts because the agreement is like any contract and has to be enforced in court by instituting an action in court by the aggrieved party.

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9 "Getting to Yes, Negotiate Agreement Without Giving In", by Roger Fisher & William Ury, pp. 40-55.

10 (a) Abid pp. 56 to 80.
(b) "Mediation & ADR Development in the Various Jurisdictions. Have the Lawyers Caught On?", by Vinayak P Pradhan, a paper presented during the 12th Commonwealth Law Conference, p. 6 'crafting settlement option'.

11 "Getting to Yes, Negotiate Agreement Without Giving In", by Roger Fisher & William Ury, p. 100.

12 George Lim, President of Law Society and Singapore Mediation Centre said that for the last three years their success rate was 78.9 per cent.

Mediation in this form has more chances of settling disputes between parties as compared to other forms of resolution of dispute because the power to settle is with them all the time. But the success or failure very much depends on the sincerity of the parties. A lack of sincerity on the part of the parties will undermine the foundation of the mediation and will frustrate the efforts of the parties and will not contribute to the success rate of mediation. Thus, if parties use the forum of mediation for any other purpose, then mediation will likely fail. The advantages of this form of dispute resolution is obvious.[13] It saves a lot of time and money for the parties.[14] In terms of time, the parties can meet as often or as quickly as they wish to resolve the dispute. In the preparation of the case, it cuts out the complexity and the rigidity of paper work, which is required under the litigation process. Further, there is an additional intangible benefit for the parties and that is the satisfaction level to be derived from meditation to the parties. The satisfaction of the parties at the end of the mediation should be higher than the other forms of dispute resolutions because they have a major say in it. Normally, in arbitration and in litigation there is only one winner and one loser and therefore there is one satisfied party and one unhappy party. The former Chief Justice, Tun Eusoff Chin (inter alias) said :

"Civil Actions are not only time consuming, but emotionally draining and expensive." as reported in *The Star* Newspaper 12 May 2000 in contrast with mediation. In mediation the two parties should be winners because it strives for a win-win situation and therefore the satisfaction level of the parties should be higher. Mediation is suitable in commercial dispute cases where money is involved and it is especially suitable in cases where the parties in dispute have an existing and profitable relationship. If litigation is applied in this case it will certainly destroy the existing and profitable relationship of the parties. Therefore, the parties are encouraged to go for mediation first before they go for litigation.[15] Mediation is also suitable in most matrimonial matters which by itself will promote the husband and wife relationship.[16] It is supposed to help the spouses to reconcile apart from settling their dispute. Even if mediation does not reconcile spouses, they help to minimise the high level of emotional conflict ever present in matrimonial matters. In the employer and employee dispute, mediation is also appropriate as an avenue for settling disputes between them although there are other legislation like the Employment Act, 1955, and the Industrial Relations Act, 1967,[17] which cover employment matters. However I am not saying that mediation is suitable for all forms of disputes. Mediation is not appropriate in matters where there is a need for publicity or a principle to be established or where interlocutory remedies are necessary. Ultimately the enforcement of the contract of settlement by the parties still depends on the courts. Such is the limit of mediation. Therefore mediation is only an alternative dispute resolution (ADR) to litigation as much as arbitration is also an alternative dispute resolution to litigation. AN

Note : MIA would like to thank the Bar Council for their generosity in allowing the Institute to reprint this article on the process and principles behind mediation as an alternative dispute resolution mechanism. Detailed administrative procedures as well as corresponding charges for such services provided by the Bar Council, can be obtained from :

The Malaysian Mediation Centre
c/o Bar Council, Malaysia
Tingkat 10, Wisma Kraftangan
9, Jalan Tun Perak
50050 Kuala Lumpur
Tel : 603-2691 1366/1367
Fax : 603-2691 2439/4316

[13] "Mediation — Charting the Right Course for the New Millennium", by Rajah Chandran (1999), 3 C.L.J. p. xv.

[14] "Painless Way to Solve Disputes" by Chelsea L. Y. Ng, *The Star* Newspaper, 30 May 2000.

[15] "Eusoff : Seek Mediators Before Going to Court" by Chelsea L. Y. Ng, *The Star* Newspaper, 12 May 2000.

[16] Law Reform (marriage and divorce) Act, 1976, s.106 refers to a conciliatory body to settle matrimonial difficulties. Mediation overlaps with reconciliation. A successful mediation brings about reconciliation between the parties. The meaning of reconciliation is not defined in the Act.

[17] S.18, 19, 19A, 19B all refer to the conciliation of the employer and employees. The meaning of conciliation is not defined in the Act. There is a slight difference in meaning between reconciliation and conciliation in the Concise Oxford Dictionary.

LOCAL ACCOUNTING AND BUSINESS NEWS

Withdrawal of Guidelines on Dealings by Directors and Related Party Transactions

The Securities Commission (SC) has on 1 June 2001 announced that with immediate effect, the guidelines set out in Chapter 5, *Dealings by Directors* and Chapter 20, *Special Requirements for Related Party Transactions* of the Securities Commission's Policies and Guidelines on Issue/Offer of Securities have been withdrawn.

This is in line with the implementation of the Revamped Kuala Lumpur Stock Exchange (KLSE) Listing Requirements which became effective from 1 June 2001, as the above-mentioned guidelines are now set out in the KLSE Listing Requirements and not those set out in the SC's Policies and Guidelines on Issue/Offer of Securities.

ACCA Leadership Camp and Outdoor Pursuit 2001

More than 120 ACCA students from all around Malaysia participated in the ACCA Leadership Camp and Outdoor Pursuit 2001, held in Cheneh, Terengganu from 29 June 2001 until 1 July 2001.

In line with the camp's objective to promote leadership skills and values, the participants took part in various activities.

It was indeed a challenging experience for the participants especially the outdoor activities. Under the tutorage of experienced rangers, all participants learned and experienced various techniques of 'wall-climbing', 'flying fox', 'jungle obstacles', 'absailing, 'rope course' and many more.

All the activities conducted focused on building leadership qualities as well as encouraging teamwork among participants. Some of the activities allowed participants to experience self-discovery, a sense of responsibility and appreciation of nature.

In some activities there were participants who really challenged themselves as they overcame their fears. One of the participants, Yong Soke Ke said, "I have always been afraid of heights and most of the outdoor activities

Participants of the ACCA Leadership Camp and Outdoor Pursuit 2001

One of the camp participants in action!

Strong teamwork among the participants

Second Queen's Award for ACCA

The Association of Chartered Certified Accountants (ACCA) has received its second Queen's Award for International Enterprise in the UK on the Queen's Birthday this year.

Before this, ACCA received its first Queen's Award in 1996 for Export Achievement. As for the second award ACCA has been honoured with the Queen's Award for Enterprise in the international trade section of the scheme. This award is a recognition of the ACCA status as the only professional body that offers a genuinely global portfolio of qualification.

Commenting on the award, Chief Executive, Anthea Rose said, "Against a background of international competition, ACCA has continued to grow. The Award is in recognition of the global role ACCA plays and the value of its work to employers, governments, students and members. We are delighted to receive it."

Upon receiving the news, Nik Roseli Mahmood, ACCA's Head of Malaysia Affairs, said, "The Award is further proof of ACCA's excellence and high standards in education, especially in accountancy qualification. Not only is ACCA the largest global accountancy body in the world, with nearly 300,000 members and students in 160 countries, but also its syllabus is recognised by the United Nations as providing a basis for the global accountancy publication." AN

involved heights. I would not have had the courage to do all those activities if not for my friends' help and encouragement."

Another participant, Poohan V. Nathan said, "One thing most noticeable in the camp is the strong teamwork. It was indeed a healthy and conducive environment to foster great friendship."

The Project Director of the ACCA Leadership Camp & Outdoor Pursuit 2001, Jessey Ding said that, "the organising committee worked very hard to ensure that the whole programme ran smoothly and I am proud to say that the participants were very, very active and committed in all activities arranged for them — they, themselves made the camp such a success!"

"The Students Ambassador of ACCA intends to make this camp an annual event, as it is essential towards sharpening leadership qualities and strengthening the unity among ACCA students from all over Malaysia", Jessey further added. AN

UM's Top Accounting Students Participate in ACCA's Public Speaking Workshop

ACCA recently organised a two-day workshop on "Dynamic Public Speaking" to top accounting students from University of Malaya. Forty-two eager participants attended the workshop, which was held at ACCA's office in Wisma Denmark on 23 and 24 June 2001.

The workshop was divided into theory explanation, demonstration by facilitators, workshops for students and presentations of selected top speakers from various groups.

For two days the students were introduced to the art of presentation and public speaking skills such as doing impromptu speeches, using humour, vocal variety and body language effectively, and preparing business presentations.

"Students of accountancy should no longer be complacent and satisfied with technical knowledge alone. They have to be proactive and complement themselves with other skills such as public speaking and presentation skills. The days when you could rise to the top simply by being good at your technical knowledge is over. Today's employers and customers simply want more and you have to get your message across convincingly and effectively", said Nik Roseli Mahmood, ACCA's Head of Malaysia Affairs.

"Investment and effort in improving communication skills is something that can help us enhance our own competency and efficiency", he further added.

The participants were intensively trained and exposed to various techniques of effective presentation.

"Unlike any other workshop, we did not learn theories alone, but there were demonstrations on how to do things effectively, immediate training and rewards for the best presenters. It was very challenging, especially when we broke up into groups for the workshop but it was fun!", said Faith Jebakumari, one of the participants that day.

According to Lai Chung Meng, "Before this I thought it was of not much use to learn public speaking skills but being here has made me realise the importance of public speaking and presentation because once you open your mouth you are being evaluated by everybody."

Nik Roseli, ACCA's Head of Malaysia Affairs with the participants of the "Dynamic Public Speaking" workshop

Best Presenter of each segment with Nik Roseli, from the left Noraini Ong Hj Maliking, Lai Chung Meng, Nik, Faith Jebakumari and Soh Hong Wee

The workshops ended with a presentation of awards and presents for the best speaker of each segment. Best Speaker for "Ice breaker" went to Lai Chung Meng, Best Speaker for "Table Topics" went to Faith Jebakumari and Best Speaker for "Body Language & Vocal Variety" was Noraini Ong Hj Maliking. As for Soh Hong Wee, he grabbed two titles, Best Speaker for "Humour" and "Effective Business Presentation".

This 'Dynamic Public Speaking Workshop' is the first of the workshop series organised by ACCA for accounting students from various universities. AN

Surviving the Current Economic Slowdown

Twenty-seven corporate chiefs and the leaders of the Chartered Institute of Management Accountants (CIMA) met at the 10th CIMA CEO Forum on 12 July 2001 to discuss survival strategies for Malaysian businesses amidst the challenges of the current economic slowdown.

Speaking on the business aspects of the Forum theme "The Impact of the US and World Economic Slowdown on Malaysian Businesses — Survival Strategies", Tan Sri Dato' Dr Lau Ban Tin, Director of B.I.G. Industries Bhd, said that Malaysian businesses have to react to the current economic slowdown and also to future challenges of globalisation, the advent of the ASEAN Free Trade Area (AFTA) and World Trade Organisation (WTO). He elaborated that survival strategies for companies were most needed in the three years before and after the WTO rules take full effect. He urged the Government to quickly form a Ministry of Foreign Investment to act as a one-stop centre for foreign investment. This will bring in much needed foreign funds to provide the working capital. Tan Sri Lau also proposed that the Financial Sector and Capital Market Master Plans be executed as soon as possible to create confidence in the KLSE. More powers should be given to external auditors to ensure confidence in the local financial market. Tan Sri Lau urged companies, whether domestic market or export led, to increase efficiency, ensure that staff are multi-disciplined and corporate gearing was low. Another survival strategy is to make Malaysia into a centre for trading, design, education, tourism and finance.

Tan Sri Dato' Dr. Lau Ban Tin, Director of B.I.G. Industries Bhd

Dr. Ghazali Atan (left), guest speaker and Managing Director/CEO of Metrowangsa Asset Management Sdn Bhd

Another guest speaker, Dr Ghazali Atan, Managing Director and CEO of Metrowangsa Asset Management Sdn Bhd, spoke on the economic aspects of the Forum topic. Dr Ghazali said that a big challenge for Malaysia was to identify its next export growth area, especially since the country's small population made it a very limited market. He stressed that under the 8th Malaysia Plan, the export-import balance was to be maintained at a positive level with export growth at 15 per cent and import growth at 10 per cent per year. This should be achievable through increased efficiency, competitiveness and continuous upgrading into new export areas. Efficiency and competitiveness (know-how) are more important than "know-who" as markets become global and more transparent.

Other proposed survival strategies included the luring of knowledge workers back to Malaysia through the reduction of income tax rates and by making it easier for foreign spouses to obtain permanent residence in Malaysia.

The CEO Forum is a yearly event organised by CIMA where a small group of CEOs from various industries get together with the leaders of CIMA to discuss current issues facing the Malaysian business community. The aim is to share the insights and expertise of these professionals for the benefit of all concerned. AN