A Newsletter of RSM AAJ Associates

Wake Up Call

Quarter IV – 2013 Edition

RSM AAJ
Audit • Tax • Advisory

contents

quote of the quarter

"quality is never an accident; it is always the result of intelligent effort"

john ruskin

New Business Creation Among BRICS Seven Times Faster Than G7 Since The Financial Crisis

As one of the world's largest networks of independent audit, tax and advisory firms, with 700 offices in over 100 countries, RSM International (RSM) is ideally placed to take the pulse of economic well-being in key markets around the world.

Knowing that business creation is one of the most telling indicators of economic vitality, we decided to conduct a comparative study of business births and deaths across the world.

Drawing on data collected by 35 RSM International member firms, and a wide variety of statistical sources, our paper examines global, regional and national trends in the entry and exit of companies.

It reviews the extent to which economies are creating and sustaining new businesses, identifying what some governments are doing to encourage entrepreneurship, and comparing the impact of the global financial crisis on business creation across diverse global economies.

Our research shows that the net rate of business creation among the BRICS has been over seven times faster than the G7 since the financial crisis.

Over the last five years (2007-11/most recent data available), the G7 countries (Canada, France, Germany, Italy, Japan, UK and US) have seen a net gain of 846,000 businesses, representing an annual compound growth rate of 0.8 per cent in the number of active enterprises.

By comparison, the BRICS (Brazil, Russia, India, China and South Africa) have surged ahead.

Over the same period, the BRICS have produced a net gain of 4.8 million enterprises, a compound annual growth rate of 5.8 per cent per annum. (See exhibit)

Governments around the world have been looking for ways to stimulate entrepreneurship in the wake of the financial crisis, but our research clearly shows that, with many businesses facing tax rises and struggling to access finance, more needs to be done to boost business creation and survival.

Of the 35 countries sampled, Hong Kong exhibited the fastest rate of new business creation over the last five years – 9.9% on an annualised basis, from 655,000 to 956,000 – while South Africa has seen the steepest decline in the number of active enterprises, – 3.8% per annum, from 956,000 to 817,600.

The research shows that Mexico has seen one of the fastest rates of increase in the total number of active businesses over the last five years, from 1.1 million to 1.4 million. The country was hit hard by the financial crisis but the recovery has been equally dramatic, with economic growth now outpacing Brazil.

As Chinese labour and shipping costs rise, Mexico is becoming a more attractive destination for businesses supplying the US market.

"Over the last five years, the BRICS have produced a net gain of 4.8 million enterprises, a compound annual growth rate of 5.8 per cent per annum."

At the other end of the table Portugal has seen the number of active businesses decline by 0.8% on an annual compound basis, from 616,000 to 596,000.

Portugal is struggling with its deepest recession since the 1970s. The government is, however, looking at ways to make Portuguese businesses more competitive and attract foreign investment, such as slashing the corporate tax rate, which currently stands at 24 per cent.

One of the most interesting contrasts thrown up by the data is the relative strong performance of European countries compared to North America (the US and Canada). Over the last five years, EU countries (12 were included in the research) produced a net gain of 1.2 million businesses, a 1.4 per cent annual growth rate over the five-year period of the study.

By contrast, North America has added just 158,000 new enterprises, representing a 0.4 per cent annual rate of increase between 2007 and 2011.

"The introduction of the auto-entrepreneur system in France, which has cut paperwork and taxes for new entrants, has led to a sustained rise in the number of active enterprises."

In this context, France is an interesting anomaly. France – often criticised as statist and lacking in business dynamism – has created new businesses four times faster than the G7 average over the period of the study (4.5 per cent compound annual growth rate). France is ranked quite highly for ease of starting a business, and the introduction of the auto-entrepreneur system in January 2009, which has cut paperwork and taxes for new entrants, has led to a sustained rise in the number of active enterprises.

Amid a global financial crisis and recession of historic proportions, entrepreneurs around the world have launched new companies in a wide range of industries. A number of these start-up companies did not survive the post-recession period, as continuing limits on growth capital and a weak global recovery forced the closure of newly-formed enterprises.

Our research shows that the surviving start-ups provide a strong foundation for economic growth in coming years: the new enterprises that managed to withstand the recent economic and financial headwinds are the ones possessing the competitive assets (skilled managers, strong technology, superior products and services) requisite for sustained growth.

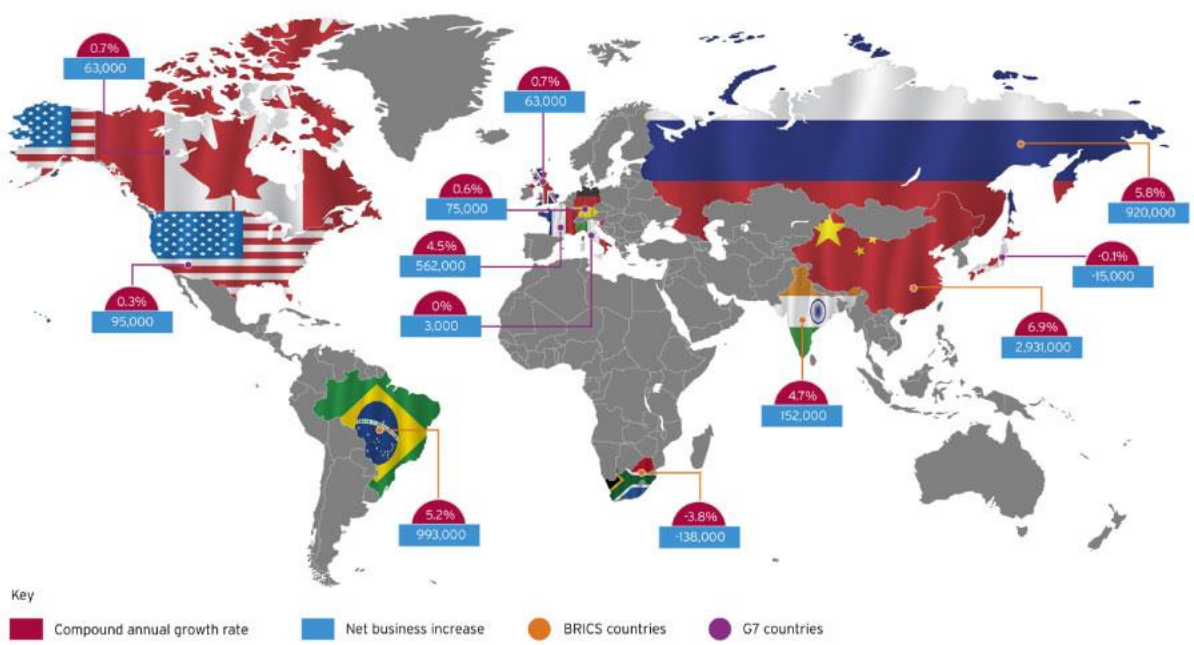
It is these enterprises that have the potential to deliver an outsized impact on productivity growth and job creation and where governments should target any supportive legislative measures to enhance their development and help them to realise their true potential.

To read the full report, or find out more about RSM's global network of independent audit tax and advisory services and how we might help you, visit *www.rsmi.com*.

This article is taken from The European Business Review (http://www.europeanbusinessreview.com/?p=9558)

Jean Stephens
CEO of RSM International

Change in number of active enterprises (in 000's), 2007-11



What Internal Auditors Need to Know on Internal Capital Adequacy Assessment Process

Independent, competent and qualified internal auditors are vital to good governance, as a strong internal control framework including an independent, effective internal audit function is part of sound corporate governance.

The Basel Committee's Principles for Enhancing Corporate Governance require banks to have an internal audit (IA) function with sufficient authority, stature, independence, resources and access to the Board.

Banking supervisors must be satisfied as to the effectiveness of a bank's IA function, which effective policies and practices are followed and that management takes appropriate corrective action in response to internal control weaknesses identified by internal auditors.

An effective IA function provides vital assurance to a bank's board of directors and senior management (and bank supervisors) as to the quality of the bank's internal control system. In doing so, **the function helps reduce the risk of loss and reputational damage to the bank.**

The Basel Committee is requiring internal auditors to review their firms' measurement and management of risks and the Internal Capital Adequacy Process (ICAAP) as an integral part of their ongoing plans.

This means that internal auditors must have a sound appreciation of what regulatory and economic capital represents and how it is calculated which in turn may demand competency in new areas of audit concern such as model risk.

BOD, BOC, Audit Committee are demanding higher standards of performance from their auditors but often the quality of the internal audit reports fails to adequately document the risk based work conducted.

Therefore, internal auditors need to understand the background of ICAAP and what is expected out of internal auditors to support such sound oversight of risk.

Basel II

Basel II is the second of the Basel Accords, (now extended and effectively superseded by Basel III), which are recommendations on banking laws and regulations issued by the Basel Committee on Banking Supervision.

Basel II, was intended to create an international standard for banking regulators to control how much capital banks need to put aside to guard against the types of financial and operational risks banks (and the whole economy) face.

Generally speaking, these rules mean that the greater risk to which the bank is exposed, the greater the amount of capital the bank needs to hold to safeguard its solvency and overall economic stability.

The First Pillar.
The first pillar deals with maintenance of regulatory capital calculated for three major components of risk that a bank faces: credit risk, operational risk, and market risk. (Other risks are not considered fully quantifiable at this stage.)

As the Basel 2 recommendations were phased in by the banking industry it will move from standardised requirements to more refined and specific requirements that have been developed for each risk category by each individual bank.

The Second Pillar.
The second pillar deals with the regulatory response to the first pillar, giving regulators much improved 'tools' over those available to them under Basel I.

It also provides a framework for dealing with all the other risks a bank may face, such as systemic risk, pension risk, concentration risk, strategic risk, reputational risk, liquidity risk and legal risk, which the accord combines under the title of residual risk. It gives banks a power to review their risk management system.

Internal Capital Adequacy Assessment Process (ICAAP) is the result of Pillar II of Basel II accords.

The Third Pillar. This pillar aims to complement the minimum capital requirements and supervisory review process by developing a set of disclosure requirements which will allow the market participants to gauge the capital adequacy of an institution.

Market discipline supplements regulation as sharing of information facilitates assessment of the bank by others including investors, analysts, customers, other banks and rating agencies which leads to good corporate governance.

The aim of pillar 3 is to allow market discipline to operate by requiring institutions to disclose details on the scope of application, capital, risk exposures, risk assessment processes and the capital adequacy of the institution. It must be consistent with how the senior management including the board assess and manage the risks of the institution.

When market participants have a sufficient understanding of a bank's activities and the controls it has in place to manage its exposures, they are better able to distinguish between banking organisations so that they can reward those that manage their risks prudently and penalise those that do not.

These disclosures are required to be made at least twice a year, except qualitative disclosures providing a summary of the general risk management objectives and policies which can be made annually. Institutions are also required to create a formal policy on what will be disclosed, controls around them along with the validation and frequency of these disclosures. In general, the disclosures under Pillar 3 apply to the top consolidated level of the banking group to which the Basel II framework applies.

Internal Capital Adequacy Assessment Process

Bank's risk management strategy and framework has to correspond to its size, characteristics, and complexity of business. Risk management at a bank covers the following aspects: (1) Risk governance; (2) Risk management framework; (3) Risk management process, HR, MIS; and (4) Risk control system.

What need to be in place for a sound assessment process to took place?

1. Develop Risk Management Policy. As part of risk management strategy and framework, a risk management policy shall first be develop.

The policy shall cover: (1) Risk governance: Risk strategy & risk appetite; BOC and BOD awareness; Governance structure; BOC and BOD oversight; (2) Risk management framework: Policy, procedures, system & limit; (3) Risk management process: Identification, measurement, monitoring & controlling; IS & HR; (4) Risk control process: Internal control; Independent review.

2. Risk Self-Assessment and Risk Measurement. Assessment of risk management quality covers the following aspects: (1) Risk governance; (2) Risk management framework; (3) RM process, HR, MIS; and (4) Risk control system.

Self-assessment covers inherent risk (quantifiable & non-quantifiable) and quality of risk management). Assessment of inherent risk includes: (a) Pillar 1 risks: credit risk, market risk, and operational risk; and (b) Pillar 2 risks: credit concentration risk, IRRBB, liquidity risk, other risks (strategic, legal, compliance, reputational).

Degree of intensity of assessment are determined by the size, characteristics, and complexity of the bank business (i.e. simple vs. complex ICAAP banks).

EXAMPLE OF INDICATORS
TO MEASURE EACH TYPE OF RISK

Credit Risk	• Changes in bank's portfolio rating, leading to increased risk weight & risk weighted asset of bank • Credit concentration on high risk industrial sector • Adequacy of provisions for non performing and low quality assets
Market Risk	• Significance of long term fix rate assets • impact on the economic value of capital under xx bps rate shocks
Operational Risk	• Gross income of the bank compared to its peer group
Liquidity Risk	• To what extent liquid asset of bank can cover non-core funding (liquid asset/non-core funding) • Sensitivity of funding sources
Other Risk	• Business strategy that focus on high risk activities, ie. entering new market vs traditional/low risk activities • Number and nominal of litigations and the impact of litigations on the bank's capital.

Complex banks are expected to present more advance risk measurement techniques and better/more advance risk management approach).

In measuring the risk, bank should consider both quantitative and qualitative aspects, as well as the proportionality, significance/materiality of risks.

3. Capital Adequacy Calculation. Bank should set aside adequate capital commensurate to its risk profile, not only for pillar 1 but also for pillar 2 risks.

Banks are allowed to use one of the following approach to determine internal capital adequacy:

- Top-down approach: Leverage off "net risk" to arrive at a range of required capital – the level of required capital increases as the net residual risk rating deteriorates.
- Bottom-up approach: Use stress testing of bank's material risk exposures and qualitative assessment of overall risk management to determine how much capital within a given range.

4. Quality Assurance and Internal Control. Bank should conduct quality assurance and review by independent party on ICAAP at least once a year to ensure quality of ICAAP in supporting risk management of bank.

Scope of review should include:

- Appropriateness of capital adequacy calculation process with bank's size, type, scope and complexity of its business.
- Identification of large risk exposures and risk concentration.
- Accuracy and completeness of data used in capital adequacy calculation.
- Reasonableness & validity of scenario used in capital adequacy calculation
- Robustness of stress test and analysis on assumptions used.

5. Documentation and Reporting. Bank should conduct quality assurance and review by independent party on ICAAP at least once a year to ensure quality of ICAAP in supporting risk management of bank.

Angela I Simatupang
Partner
Risk Advisory Practice

in welcoming the month of December,
we would like to post a special greet
to all readers of **Wake Up Call**...

Merry Christmas !

News From Our Office

rsm world day 2013

RSM World Day 2012 was always going to be a tough act to follow. Like many musicians say, the second album is always a lot harder to perfect than the first. However, RSM member firms have not suffered from the 'second-album syndrome'.

As with last year, many member firms chose to celebrate the second RSM World Day doing charitable work in their communities. The list is long but activities included mango seed planting in Malaysia, reforestation work in New Zealand and Lebanon, painting colourful dog kennels in South Africa, packing school bags for children in areas devastated by floods in the Czech Republic and visits to a children's hospital in Venezuela – all of this work contributed to the communities of our member firms.


RSM

INSIDE: RSM connects to make a world of difference

RSM World Day News

September 2013

Digging Deep for RSM World Day

New Zealand: RSM Prince

News From Our Office

RSM World Day celebration in Indonesia

On 12 September 2013, RSM AAJ visited a nursing home in Jakarta, namely Panti Sosial Tresna Werdha Budi Mulia. The Home is occupied by around 180 elderlies that have no ability to take care of themselves. Most of them were financially incapable, some were abandoned by their families, and some were even found on the streets.

So, on RSM World Day, we visited them, introduce RSM and reasons for visiting, and arranged a free medical check. Our team is supported with doctor and nurses to check their individual health-being, and after the examination, everyone was given a relevant prescription to their needed medicines which they can redeem from our medical supplies team on-site, and all were given vitamins as well. As the health check being conducted, we entertained the remaining elderlies who are still waiting in turn for the checkup. We invited them to tell their stories, as well as singing and dancing.

Some of the elderlies that opt to sat or were too weak to be in the communal room were visited by us in their room and we just spent time to chat and listen to them.

It was a very touching experience for the team that visited the Home. We learned what being connected is about; they were happy out of simple things like being visited and greeted, to have people care for them. Although we only spent half a day there, we believe that compassion is the foundation that connected us.

September 2013

United States: McGladrey LLP

McGladrey staff participated in 'RSM World Day coffee breaks' held in over 30 offices across the USA. More than any other country, McGladrey staff took on the challenge of 'Where on Earth?'

Valued connections through understanding and genuineness

Indonesia: RSM AAJ Associates

"It was a very touching experience for the team that visited the home. The residents were happy with simple things - being visited and greeted and to have people care for them. We believe that compassion is the foundation that connects us."

A team of staff from RSM member firm in Indonesia visited a nursing home in Jakarta called Panti Sosial Tresna Werdha Budi Mulia. The Home is occupied by around 180 vulnerable elderly people many of whom are not visited by their relatives. The team, supported by doctors and nurses, arranged for free medical check-ups and medicines and spent time talking with the residents and hearing stories about their lives.

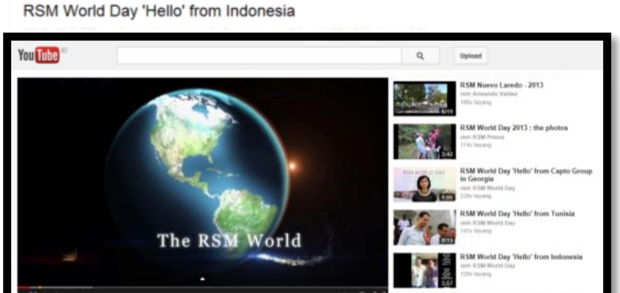
Back at the office, all of the staff watched the RSM World Day presentation, before teaming up to compete in a game of RSM trivia - a fun and interesting way to learn more about the network.

RSM AAJ used Facebook, Twitter and LinkedIn to promote their RSM World Day messages.

We learned that valued connection can only be made through understanding and genuineness. Certainly that's valid for servicing clients as well.

Returning to the office by midday, we started our internal activities. We gathered in a more informal ambience, and started the RSM World Day presentation with our Chairman's opening, and end it with a show of the Hello RSM Video. (Hello RSM Video from Indonesia can be watch at http://www.youtube.com/watch?v=WdWMEWiUcc4)

RSM World Day 'Hello' from Indonesia



RSM World Day 2013 : the video

Last activity carried on that day was a game of trivia on RSM which includes team representing each group within the office to compete. The purpose of having this game was to one way of educating and enriching staffs' knowledge about RSM network, but packaged it in a more fun way.

So, on RSM Day... **we were rewarded because we can be of value to others**, and we also had fun. **Now that's a celebration of RSM**.

News From Our Office

rsm itax academy

Last October, 32 tax professionals from member firms across the RSM world attended the first of two residential weeks training in the Netherlands at the RSM ITAX Academy.

Delegates came from Brazil, Chile, China, Czech Republic, Egypt, Georgia, Germany, Hong Kong, Hungary, India, Indonesia Israel, Kenya, Netherlands, Poland, Singapore, South Africa, Switzerland, United Kingdom and the United States. **Senior Manager from Indonesia, Eny Susetyoningsih of tax & outsourcing practice was among those delegates.**

As the world's fifth largest provider of tax services, the creation of RSM ITAX Academy was to ensure that its top leaders in cross border tax have the very best technical and client advisory skills.

The RSM ITAX Academy includes two residential weeks at NH Koningshof, Eindhoven, together with regular webcasts and extensive home study. It is led by members from the RSM Centre for Excellence for Tax in partnership with academics from the University of Amsterdam.

The first week included a broad range of themes from cross border income and capital gains to hybrid entities and the OECD Model Tax Treaty.

Throughout the coming year RSM ITAX Academy will provide webcasts on various topics and the second-residential week in October 2014 will include GTS principals, EU Law and tax treaty anti-avoidance provisions.

This programme is vital to the development of our international tax offering and drive help RSM member firms in developing a critical mass of international tax professionals capable of serving large internationally active clients.

News From Our Office

past events

capitalising on indonesia's diverse investment opportunities
jakarta, august 2013

RSM AAJ partnering with UOB Ltd Singapore on understanding Indonesia and Southeast Asia's growing appeal for FDI. The symposium was designed to provide a wide range of relevant and critical information for foreign investors keen on investing in Indonesia and Indonesian businesses who are keen to partner with these foreign investors. To give you a pulse of what is actually happening on the ground, this symposium will also include a commercial office location.

During the symposium on 22 August, **our partner, Nick Graham of tax & outsourcing practice was presenting the topic of Indonesian Tax – Myths and Realities.**

nusantawa, indonesian stand up comedy night
sydney, october 2013

As one of RSM AAJ's mission is to provide a rewarding and enjoyable professional working and learning environment, for many years, the firm has been in cooperation with several education institutions by providing internship opportunities.

Starting 2012, we have been receiving interns from the University of Sydney, an Australian public university in Sydney. Founded in 1850, it is Australia's first university and is regarded as one of its most prestigious, and list among top 50 most reputable university in the world.

Among the alumni of RSM AAJ's interns from the University of Sydney were active in PPIA University Sydney (the Sydney University official Indonesian Students Association), and as part of their act in promoting Indonesia, they invited top stand-up comedians from Indonesia to perform at the Sydney Conservatorium Hall of Music.

RSM AAJ was proud to be able to support such initiative of these young people, the generation of our future leaders.

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