

AAT: The indispensable element **April 2010**

T/DIALOGUE

Technology
gives SMEs the edge



Hong Kong Institute of
Accredited Accounting Technicians
香港財務會計協會

Table of Contents

Technology gives SMEs the edge



3



8



24

2 From the President's Desk

HKIAAT News

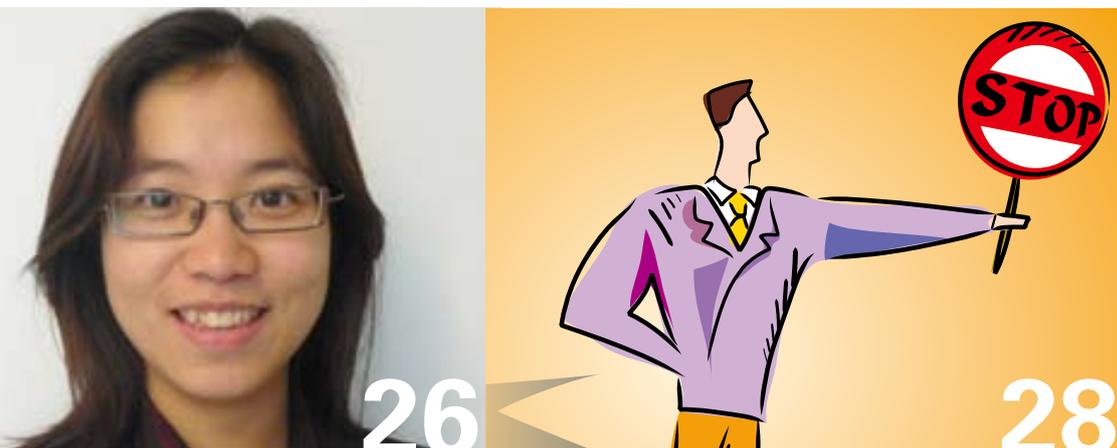
- 3 Education & Careers Expo 2010
 - 4 Annual Award and Graduation Ceremony cum New Members' Reception
 - 5 Membership and Studentship Fees for 2010 – Final Reminder
 - 5 Interest-free Loan
 - 6 Recalling HKIAAT's Study Text for AAT Examination Paper 6
 - 7 Module Certificate for the AAT Examination Preparatory Courses
-

Cover Story

- 8-12 Improving SME efficiency through computerization
-

Learning Zone

- Professional Bridging Examination (PBE)*
 - 14 Paper II: Incremental Analysis for Decision Making – by Simon S P Lee
 - 15 Paper IV: Stop Abusing the Protection of Wages On Insolvency Fund! – by Stephen Chan
-



Learning Zone

- 16 *Accredited Accounting Technician (AAT) Examination*
Paper 4: Graphical Presentation for Statistical Data –
by Y O Lam
- 17 Paper 5: Taxation of Environmental Protection Installations –
by Dr. Dora Lee
- 18 Paper 5: Highlights of the Revenue Proposal in the 2010/11
Budget – by Dr. Dora Lee
- 19 Paper 7: HKAS 24 (Revised) Related Party Disclosures –
by Dr. M H Ho
- 20 Paper 8: Modifications to Auditor's Opinion & Auditor's
Report – by David Chow

Careers and Lifestyle

- 22-23 Employer in the Spotlight – Y L Yeung
- 24-25 Versatile AAT – Mandy Ngai
- 26-27 Passport to Success – Jasmin Yim
- 28-29 The Gut Types of Enneagram – by William Tong
- 30-32 Negotiation Skills – by Weelan Ho

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April 2010

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From the President's Desk

Dear members and students,

We were delighted to hold the HKIAAT Annual Award and Graduation Ceremony cum New Members' Reception earlier this month. May I take this opportunity to congratulate once again all the award winners, scholarship recipients and graduates on their outstanding performance. I am particularly pleased to note that our new members excel in their careers with the AAT designation, and are making contributions in many industries and sectors.

The ceremony was certainly a highlight of the year. With the successful launch of the new qualification framework, we continue to strengthen our brand image and enhance the status of the AAT qualification. Our success is evidenced by the positive year-on-year growth in our new student numbers in recent years. With your staunch support, I am confident that the AAT qualification will become the most preferred qualification in the accounting technician sector.

I am a strong believer in continuing education. To prosper in today's environment, we must strive to improve our skills and knowledge. It is this belief that has driven us at the HKIAAT to design a top-up degree programme for our members and graduates — the Bachelor of Professional Accounting with Honours. Upon completion of the programme, graduates become degree holders and at the same time eligible for entry to the Hong Kong Institute of CPA's Qualification Programme (QP). This degree programme jointly offered by the Hong Kong Institute of CPAs and the Open University of Hong Kong has been very popular with our graduates since its launch last year. Applications for the 2010 intake are now open. Don't miss the chance to enhance your qualification.

The design of the AAT examination syllabus not only equips our members and students with professional knowledge, but also gives them practical skills required in their daily operations and the ability to provide solutions for business. As we see in this issue's cover story, businesses today are using computerized accounting systems, something many of them see as essential for their survival. This is one of the many challenges facing small and medium sized enterprises (SMEs) today. It explains why our graduates and members, who have a sound knowledge of accounting software, are highly sought after by employers, especially SMEs.

With our concerted effort to promote AATs to the commercial sector, I have no doubt that our members and students will continue to be held in high esteem. Nevertheless, we should all remember that only with up-to-date knowledge and relevant experience, together with our hard work and determination, can we face every situation with confidence.



Johnson Kong
President

Education & Careers Expo 2010

HKIAAT and its parent institute, the Hong Kong Institute of CPAs, participated in the Education and Careers Expo 2010 which was held from 4 to 7 February 2010 at Hong Kong Exhibition and Convention Centre. This four-day event attracted more than 190,000 job seekers and people who were looking for further

study and training opportunities. We run two seminars during the expo to explain the AAT qualification and the progression pathways in the accountancy profession. Over 200 people attended these seminars.

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HKIAAT Annual Award and Graduation Ceremony cum New Members' Reception

On 1 April 2010, we held our Annual Award and Graduation Ceremony cum New Members' Reception 2009-10. Over 200 distinguished guests attended including government officials, members of academia, and accounting professionals. We were proud to have Mr. Chu yam-yuen, JP, the Commissioner of Inland Revenue as our guest-of-honour. During the ceremony, 22 top students of the AAT Examination and PBE received

an award of merit. In addition, 23 outstanding accounting students from 16 tertiary institutes received HKIAAT scholarships, five secondary school students received an Applied Learning scholarship, and five Employees Retraining Course (ERC) candidates received an ERC scholarship. This year, the HKIAAT also conferred certificates to graduates of the AAT Examination and PBE and to new members.

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A top student receiving her prize from the guest-of-honour Chu yam-yuen, JP.



Scholarship recipients receiving awards from HKIAAT president Johnson Kong.



HKIAAT executive director Georgina Chan conferring certificate to a new member.



Graduates from the June and December 2009 AAT Examination sessions with honourable guests.



Membership and Studentship Fees for 2010 Final Reminder

Members and students are reminded to renew their subscription IMMEDIATELY if they have not already settled their annual membership fees (\$700) or studentship fees for the Professional Bridging Examination (PBE) (\$700) or the AAT Examination (\$600) for 2010. Failure to settle these fees means their names will be removed from the relevant register in May 2010. Members and students whose names are removed must pay their registration fees and status-retaining fees (if applicable) again in order to be re-instated. So renew now and save the costs of re-registration and re-instatement of examination status.

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Interest-free Loans

Members and students of the HKIAAT who have financial difficulties paying their HKIAAT-related fees may apply for interest-free loans from the HKIAAT Trust Fund. The maximum loan amount is \$10,000. The loan can be used for financing the following categories of fees:

1. HKIAAT member / student annual fee; and / or
2. HKIAAT examination / exemption fee for AAT Examination, Professional Assessment (PA) or PBE; and / or
3. tuition fee for HKIAAT accredited programmes or revision courses for the AAT Examination, PA or PBE.

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For more details of the terms and application procedures for these loans, visit our website at www.hkiaat.org.



Recall of the HKIAAT Study Text for **AAT Examination Paper 6**

Kaplan Financial (HK) Limited, the publisher of the HKIAAT's official study texts for the AAT Examination, is now recalling study text for AAT Examination Paper 6: Fundamentals of Business Law, with immediate effect:

Study text title:

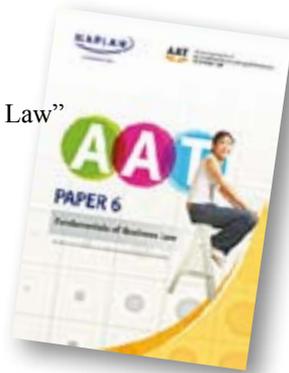
AAT Examination Paper 6
"Fundamentals of Business Law"
(Paper 6 Study Text)

Editions:

2008 & 2009

ISBN:

978-988-17210-6-8



HKIAAT students may now redeem a copy of the 2010 edition of the Paper 6 Study Text by returning your copy of either 2008 or 2009 editions, or the redemption coupon issued by Kaplan, at one of the following addresses from 11 February to 31 May 2010:

- HKIAAT – 27/F Wu Chung House, 213 Queen's Road East, Wanchai, Hong Kong (tel. 2823-0600)
- Kaplan Admiralty Campus – Unit 2, 1/F Far East Finance Centre, 16 Harcourt Road, Admiralty (tel. 2526-3686)
- Kaplan Wanchai Campus – 1/F Lucky Centre, 165-171 Wanchai Road, Wanchai (tel. 2116-3704)

Kaplan would like to express its sincere apologies to all students of AAT Examination Paper 6 for any inconvenience caused.

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Module Certificate for the AAT Examination Preparatory Courses

Students who are planning to take the AAT Examination have more options than ever before in preparing for their papers. The Employees Retraining Board (ERB) will offer part-time training courses, called the "Module Certificate in Accredited Accounting Technician Training", for the AAT Examination. The courses are aimed at students preparing for the following AAT Examination papers:

Paper 2

Business Communication and Organization and Management

Paper 3

Management Accounting

Paper 5

Fundamentals of Business Law

Paper 6

Principles of Taxation

Course duration

Each module includes 48 hours' tuition.

Course fee per module

\$2,750 For students with a monthly income of more than HK\$15,000

\$825 For students whose monthly income level between HK\$7,001 and HK\$15,000

Free For students with a monthly income less than or equal to HK\$7,000

For more details, check out the ERB's website www.erb.org or call ERB hotline 182182.





Improving SME efficiency through computerization

By Eddy Lee

Coming up with a brilliant, innovative business idea is what makes or breaks a profitable enterprise. However, proper accounting software plays an important role too, especially when in small and medium-sized enterprises (SMEs) – companies that often work with tight budget constraints. Two SMEs tell us about their experience of the benefits of using appropriate computerized systems. They explain how, with just a click of the mouse, they can save costs and time, boost efficiency and so survive in today's competitive market.

Imagine how tedious and time-consuming it would be if you had to verify the accuracy of a pile of vouchers one by one? Or, how disastrous it could be if you wanted to place an order for 10,000 pieces, but ended up mistakenly putting in an order for 100,000 pieces? Thomas Chan, owner of Picture Mate Optronics Ltd, recalls a calamitous experience from a previous employment.

“Someone messed up by keying one extra zero into the Excel spreadsheet. We ended up placing an order that was 10 times larger than we required,” says Chan. “It was a very painful experience. Just think of what we had to go through when negotiating with our supplier.”

Chan, who now runs an electronic parts trading company with 43 staff, moved to a computerized accounting system less than one year after setting up operations. “I just couldn't stand the way things were with the manual accounting management,” Chan says.

Several different computerized accounting options are available; the right choice for any company depends on

the size of operations and nature of the business. While Chan uses MYOB, other popular basic and economic options include Quickbooks, DacEasy and Peachtree.

Reasons for computerization

The main reasons for computerizing the accounting system are to smooth operations, to enhance efficiency, to simplify work and to minimize inaccuracies.

Historically, transactions have been manually recorded on sheets of paper or entered manually into spreadsheets under separate files such as accounts receivable, accounts payable, inventory control, order entry and payroll. These ledgers have then been updated into a general ledger to reflect up-to-date transactions.

In an automated computerized environment, each transaction is only entered into the consolidated system once. The information is then automatically uploaded to various accounting records, unlike a manual entry system where multiple entries are required.

When it comes to retrieving data, a user is just one click away from pulling out the files, saving time from having to request spreadsheets files from colleagues and waiting for their responses. Various types of analytical reports can be generated on demand. For instance, management can compile a report on performance of top and worst salesperson, or put together cashflow forecast for a designated period.

In the past, stock management was like a card game to Chan, but a head-spinning one involving a 200-card deck. “In the past, we kept track of our stocks manually with PIN cards. We managed our inventory by running checks of physical stock against the cards that represented different parts and items. Now that only one accounting entry is needed for each transaction and with more up-to-date information, there is less room for error.”



“I just couldn’t stand the way things were with the manual accounting management,” Thomas Chan says, a SME owner.

Chan also benefits from the system during the tax season, as the use of computerized records helps reduce audit expenses. He can simply run a template which will automatically generate the required files into a neat, accurate report for the auditor. This saves the hassle of engaging an accounting professional to compile separate accounts for auditors. As a result, Chan saves some HK\$8,000 to HK\$10,000 each year.

Picking the right system for your business

While your choice of system largely depends on personal preferences, Chan thinks there are a few rule of thumb one should follow when deciding on which brand to go with.

“Simplicity tops the list; at least that’s what I think. You want a system that can reduce work, not increase it,” Chan says, adding that the system he adopts has only five commands.

That explains why, of the 10 staff Chan employs in Hong Kong, the accounting department consists of only one full-time and one part-time staff member. The full timer is in charge of the accounting system, with the part-timer performing data entry channeling from mainland China.

New users should consider the cost of the system, maintenance charges, whether one needs to pay extra for additional functions, and the capability to run a backup of files.

Flexibility should not be overlooked, Chan adds. “Some systems may have their settings configured to a particular inventory accounting measure, such as last-in-first-out or first-in-first-out. With some systems, users would not

be able to revise exchange rates and will have to bear the same rate for a year before they are allowed to make alterations.”

Making the move

Some argue a computerized system has less flexibility than a manual system. Also many people are not happy with moving from their comfort zone of a system they are familiar with and which has stood the test of time.

Tommy Choi, business consultant at Top Dragon Consultants Limited trading MYOB, tells a story of a client who adopted the computerized accounting system in 2005 for his car-seat manufacturing business. Choi found out three years later that the business owner’s mother, who is in charge of the accounts, had also been keeping a manual set of books because she was skeptical about the credibility of a computerized system.

“She was worried that the system would crash and all data could go missing, so she ran her own set of books in parallel with the system for all those years. It took her three years to gain confidence in the system!” Choi says.

The older generation is wary about leaving their comfort zone. They are reluctant to change since they are worried that they will not be able to maneuver their way around a computer system. But what about business owners? Many don’t understand what a computerized system could do for the business. For instance, retailers or restaurateurs might mistake accounting software as being a point-of-sales system. Others worry about confidentiality and the stability of the system, not to mention the costs of purchasing and maintaining the software.

“It takes time to educate the SME business community. Many younger generation accounting personnel know how to run a computerized accounting system,” Choi says. The Accredited Accounting Technician (AAT) examination, for instance, incorporated computerized accounting into its syllabus as early as 2001.

“This generation of students is the one to initiate wider use of computerized systems in the business world. I envisage a rise in implementation of computerized accounting system among SMEs,” Choi forecasts.

Keeping up to date

It’s unlikely that a company will be able to settle with one computerized accounting system within its lifetime. As time goes by, owners may need to upgrade their software so as to keep pace with ever-changing computer technologies and expansion plans. Start-ups, such as Chan’s Picture Mate, could one day face the same challenges once encountered by Sun-Wa Technos (H.K.) Co. This Japan-headquartered electronic components trading firm, which has a monthly turnover of between USD\$2 million and USD\$3 million, chose to adopt a more powerful system after the firm’s previous software was no longer compatible with the company’s latest operating system, says Michelle Cheung, finance & admin group assistant manager.

“We are currently using FlexAccount. There were times when the old software company could not recover our original data. Also, because the old system was not



Both Michelle Cheung and Ricky Leung agree that having a computerized system is one of the keys to business success.

compatible with our new operating system, we had trouble retrieving historical data,” Cheung explains. The consequence: the company failed to provide quotations for a client in a timely manner because it had difficulty retrieving data from its system immediately. “Back then, it took us several days before being able to provide our client with a quotation. That sparked complaints from our clients and tarnished our reputation. We also risked losing clients because of our inefficiency.”

Now, after the upgrade, Cheung says data can be retrieved swiftly and reliably manner. It also helps inventory control and boosts efficiency. For example, with the new system, Cheung can immediately run a check on the inventory level upon a client’s request.

“Instantly, we know if we have inventory for a certain item, and we can get back to our clients right away to tell them whether we can take their orders,” Cheung says. Without this system, the company would have to do a stock take at the warehouse before knowing if it had sufficient stocks to fulfill an order. That takes time and is not good for client relations.

Business operators should also consider whether the selected software is able to handle multiple users simultaneously. Logistics companies and banks, companies with large operations, often require over 150 users to simultaneously log on to a system. Cheung’s company, which has 20 staff in Hong Kong, of which three are accounting personnel, sees its current system allowing as many as 18 users to log in to the system at once, handling daily operations such as answering customer inquiries. This drastically outperforms the previous system when there were inadequate user quotas, leading to operational inefficiencies.

Maintenance and support

Business suffers when it takes days before a service

provider can send staff to deal with system problems. Cheung recalls the company’s painstaking experience with a previous software provider. Operations were brought to a standstill because no-one could access the database, leading to significant delays in answering customer inquiries.

Life is easier for users when providers can offer diagnosis or assistance on site or off site, such as via the telephone. “If problems can’t be solved instantly, at least the providers can pull out historical records for temporary use,” Cheung points out.

Cheung says that accounting software rarely requires regular maintenance; however it’s a different story when it comes to an Enterprise Resource Planning (ERP) system (ERP). The user company sometimes has to rely on the ERP system provider to help create or modify modules and configure tables that are tailored to an ever-changing business environment. For example, the company might need to alter the invoice system if it decides to do business in currencies other than the US dollar.

“Its not surprising that company owners are willing to spend more for a better system as this gives them peace of mind and helps them save time and retain customers,” Cheung says.

Computerization as the key to survival

Systems like MYOB are designed for small enterprises ranging from a one-man-band operation, in which the owner needs know immediately if his enterprise is making or losing money. Organizations with staff numbers ranging from less than a dozen to as many as over 1,000, or companies which have branches or operations in different areas, can move up to systems such as FlexSystem, SAP and Oracle.

A business with over 500-600 monthly transactions should

consider adopting a computerized accounting system, but an operation with only few vouchers per month might be better off sticking with manual accounting management.

Ricky Leung, senior solutions manager of FlexSystem, says the cost of implementing the system can range from tens of thousands to hundreds of thousands Hong Kong dollars, depending on various factors including the size of the company and its nature.

The cost is lower for investment trading firms, for instance, who simply require basic accounting modules to produce financial reports for submission to the Hong Kong Stock Exchange. Implementation costs increase when an enterprise needs additional modules other than accounting, such as sales order and purchasing order, inventory control, manufacturing order and ERP modules while FlexSystem has specific solutions for different industries such as trading, garment manufacturing and chemical product makers. Large-scale enterprises with operations around the globe can enjoy the simplicity of gaining access to the same system from different parts of the world.

“Owners are prone to losing businesses and lagging behind competitors if they don’t go down the computerized path when their operations grow to a considerable size. I just do not see how entrepreneurs can walk away from computerized systems and still succeed,” Leung says.

Having a proper computerized accounting system does not guarantee entrepreneurial success, but a dysfunctional system can adversely impact corporate expansion. SME owners should review the adequacy and compatibilities of their existing systems from time to time, as complacency in this area can be detrimental to a company’s health.

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Be the initiator and make difference!



AAT graduate Connie Yeung is typical of the next generation which is reshaping the accounting landscape. She initiated the migration from a manual accounting system into a computerized one in the trading company she works for in 2005, shortly after joining.

“I got fed up with our old system. It was too inefficient,” Yeung recalls. Under the old system, the same financial data had to be entered several times in different ledgers, and each entry had to be manually cross checked by a member of the accounting team. It often took two to three hours to verify the accuracy of 2,000 payment entries of one client. This time requirement was shortened to merely half an hour following the implementation of the new system. The company is currently using SUN System for its accounting and plans to adopt Kingdee as its fixed asset system.

But it was not so easy for Yeung to get her colleagues to give up using the manual booking system. “Colleagues who had been around for quite some time were adapted to the old ways and were reluctant to make changes,” Yeung recalls. “Some of the older generation had reservations about working with computers.”

To smooth out the transition, Yeung spent much of her time researching to find a system that catered to her company’s operational needs. To facilitate usage among her colleagues, she took up the role of a trainer in helping her colleagues.

Yeung’s perseverance is certainly a leading quality that employers look for among job candidates. Academies laid the groundwork, but taking knowledge further depends on a person’s desire to learn. Many companies, when hiring accounting personnel, opt for someone who has expertise or experience in well-known accounting software. “School teaches you the basics; you need to learn the rest on your own,” Yeung says.

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Incremental Analysis for Decision Making

(Relevant to Paper II – PBE Management Accounting and Finance)

Simon S P Lee, The Chinese University of Hong Kong

Incremental analysis is a key topic in decision-making questions. These questions include deciding on acceptance of a special order; optimal production mix with constrained resources; adding or dropping a product line or a segment; making or buying a component or part; selling, scrapping or rebuilding defective products and further processing of joint products after being split off.

Incremental means difference. The best way to analyze the situation is to compare the profit and loss before and after taking the decision.

Acceptance of a special order

This refers to the situation when a company receives requests to provide a product or service which is not on their regular schedule. Before management makes their decision, they have to assess if additional profit is brought in by the accepting the order.

For example, PBE Company produces caps for sports with brand names. The company currently produces and sells 200,000 caps and has a monthly fixed cost of \$500,000. The variable cost per cap is \$4 which consists of \$3 direct material and \$1 direct labour. Each cap is sold for \$10 to sports retailers. If PBE receives a special order for 15,000 caps at \$9 each, should management accept this order?

First we assume that PBE has the spare capacity to take up the special order. The fixed cost of \$500,000 is incurred no matter whether PBE takes up the order or not. This is a sunk cost which is irrelevant to our decision-making process. The only concern is whether, after taking up the

order, the company can bring in any additional profit. We can present the result as follows:

	Order rejected	Order accepted
Revenue	\$0	\$135,000
Cost	\$0	(\$60,000)
Profit	\$0	\$75,000

When the order is rejected, no additional revenue is received and no cost incurred. If the order is accepted, PBE will report an additional profit of \$75,000.

If PBE is already running at full capacity, there is no surplus to accept the additional order. If the order is accepted, current orders will have to be given up. Accepting an order of 15,000 caps of \$9 each means PBE has to give up the original order worth \$10 each. The result can be presented as follows:

	Order rejected	Order accepted
Revenue	\$0	\$135,000
Cost	\$0	(\$60,000)
opportunity cost	\$0	(\$90,000)
Profit	\$0	(\$15,000)

The only difference with the previous situation is the opportunity cost of \$90,000 which is the cost of giving up 15,000 caps worth \$10 minus the variable cost of \$4. If the order is accepted, the loss is \$15,000. Therefore, the order should not be accepted.

In the full article, we continue by assessing the feasibility when some of the fixed overheads are avoidable and when there are limited labour hours. The technique is also extended to handling a decision on adding or dropping a business segment.

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To read the complete article, visit the Learning Centre on our website at www.hkiaat.org/index.php/services/index/199/

Stop Abusing the Protection of Wages On Insolvency Fund!

(Relevant to Paper IV – PBE Business Law and Taxation)

Stephen Chan, The Hong Kong Polytechnic University

Peter, an employee at a restaurant in East Point City, went to work as usual in the morning, only to find that his employer's business had folded. He and his colleagues sought help from the Labour Department, saying the restaurant, which had operated for about a year, owed wages to them. When Peter and his colleagues contacted their employer, Alex, he alleged that he was just a shareholder of a private company which employed Peter and his colleagues and he was not liable to pay them any unpaid wages. As a result, Peter and his colleagues had to claim their unpaid wages from the Protection of Wages on Insolvency Fund (Insolvency Fund) under the Protection of Wages on Insolvency Ordinance (Cap. 380).

The Insolvency Fund was set up in 1985 for workers to claim back pay when their employers go bankrupt. Unpaid workers can apply for payment of up to four months' outstanding wages to a maximum of \$36,000. They can also apply for payment of one month's wages in lieu of notice to a maximum of \$22,500 and a severance payment of up to \$50,000 plus half of the remaining balance. Peter and his colleagues finally back their unpaid wages from the Insolvency Fund.

However, this is not the end of the story. A few weeks later, Peter found that Alex had opened another restaurant using a similar name at the

same location. Peter's colleagues were glad to be employed by this new restaurant as they were getting better pay. Alex's case is not unusual in Hong Kong. It seems that the Insolvency Fund is abused by some restaurant owners who set up different limited companies to run their restaurants.

In law, registered companies are recognized as having their own legal personality and can exist separate and distinct from their members and managers. However, if a company is used as a means to commit fraud or to violate legislation, the court may lift the corporate veil and treat the company and its shareholders as one entity. As a result, the shareholders may be liable for the debts of the company. The whole point of lifting the corporate veil is to look behind the facade to establish those who are exercising real and actual control of a company. Therefore, if a restaurant owner uses a private company to evade his obligation to pay his employees and abuses the Protection of Wages on Insolvency Fund, the court may lift the corporate veil and hold the restaurant owner liable to pay the unpaid wages. This may be one of the solutions to preventing abuse of the Insolvency Fund by restaurant owners, although the ultimate solution may be to modify the provisions of the Protection of Wages on Insolvency Ordinance (Cap. 380).

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To read the complete article, visit the Learning Centre on our website at www.hkiaat.org/index.php/services/index/199/

Graphical Presentation for Statistical Data

(Relevant to AAT Examination Paper 4: Business Economics and Financial Mathematics)

Y.O. Lam, SCOPE, City University of Hong Kong

Introduction

Graphical presentation data is the most convenient way of describing statistical data. It is easier to understand and interpret data when they are presented graphically than using words or a frequency table. A graph can present data in a simple and clear way. Also, it can illustrate the important aspects of the data. This leads to better analysis and presentation of data.

Bar charts

Bar charts are presented using vertical or horizontal bars. Bars may be drawn separately from each other. Bar charts are used when comparing values of multiple variables. It is important that each bar should be the same width to avoid presenting misleading information.

Histograms and frequency polygons

Histograms or column bar charts are the commonly used to present frequencies in number of categories. Other commonly used graphical presentation methods include frequency polygons and ogives. Histograms portray an unequal width frequency distribution table for further statistical use. A frequency distribution table is a tabulation of the n measurements into k mutually exclusive classes showing the number of observations in each. The bars appear in a histogram where the classes are marked on the x axis and the class frequencies on the y axis. It is important to notice that a bar chart does

not have x -axis units. The histogram is constructed by creating x -axis units of equal size and these should correspond to the frequency table.

Histogram and simple bar charts are similar, except for the following:

1. A histogram depicts a frequency distribution using a series of adjacent rectangles.
2. The height of each bar in histogram is proportional to its frequency.
3. A simple bar chart can be used to show nominal and ordinal data and histogram is only used in interval-ratio data.
4. A histogram presents rectangles with class intervals on the x -axis and the corresponding frequencies on the y -axis.

Frequency polygons consist of line segments which are drawn by connecting the points formed by the intersections of class midpoints and class frequencies.

Ogive or cumulative frequency polygon

Lastly, if we want to know the number of observations “below” or “above” a certain value in the study data, this value can be estimated by using a cumulative frequency distribution. The cumulative frequency distribution can be portrayed graphically in an ogive or cumulative frequency polygon.

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To read the complete article, visit the Learning Centre on our website at www.hkiaat.org/index.php/services/index/199/

Taxation of environmental Protection Installations

(Relevant to AAT Examination Paper 5: Principles of Taxation)

Dr. Dora Lee

The Inland Revenue Ordinance 2008 was enacted to provide accelerated tax deductions for environmental protection installations as from 27 June 2008. The enactment affects the profits tax computations of businesses concerned for the year of assessment 2008/09 and thereafter.

The term “environmental protection installations” (EPIs) is defined in Part 2 of Schedule 17 of the Inland Revenue Ordinance (IRO) as:

1. Any of the following installations -
 - a) solar water heating installations;
 - b) solar photovoltaic installations;
 - c) wind turbine installations;
 - d) offshore wind farm installations;
 - e) landfill gas installations;
 - f) anaerobic digestion installations;
 - g) thermal waste treatment installations;
 - h) wave power installations;
 - i) hydroelectric installations;
 - j) bio-fuel installations;
 - k) biomass combined-heat-and-power installations; and
 - l) geothermal installations.
2. Energy efficient building installations registered under the Hong Kong Energy Efficiency Registration Scheme for Buildings administered by the Electrical and Mechanical Services Department.

The Secretary for Financial Services and the Treasury is empowered to amend the list of specified EPIs under

Schedule 17 by notice published in the Gazette after consulting the Director of Environmental Protection (section 16H(3) of the IRO).

Any capital expenditure incurred on the provision of any EPI, excluding expenditure:

- that can be deducted under another section of the IRO or
 - incurred under a hire-purchase agreement,
- by a person on or after 27 June 2008 can be deducted in five equal yearly instalments, subject to apportionment if not 100 percent used in the production of chargeable profits (section 16I).

EPIs acquired and in use before 27 June 2008 may also qualify for accelerated depreciation if a valid election is made.

The article explains:

- the tax treatment for specified capital expenditure on EPIs acquired on/after 27 June 2008;
- the tax treatment on disposal of EPIs including the following situations:
 - sale between connected persons,
 - destruction of EPIs;
- how to determine the time of sale of EPIs;
- the tax treatment of EPIs acquired before 27 June 2008; and
- how to make an election for accelerated deduction in respect of EPIs acquired before 27 June 2008.

Related examples and calculations can be found in the article to illustrate the relevant tax treatment. **T/D**

To read the complete article, visit the Learning Centre on our website at www.hkiaat.org/index.php/services/index/199/

Highlights of the Revenue Proposals in the 2010/11 Budget

(Relevant to AAT Examination Paper 5: Principles of taxation)

Dr. Dora Lee

On 24 February 2010, John Tsang Chun-wah, the Financial Secretary, made his third Budget Speech, this one for the financial year 2010/11. Mr. Tsang is cautiously optimistic about the economic outlook, though uncertainties and potential pitfalls remain in the external environment.

His proposals relating to income tax are:

- 75 percent of salaries tax and tax under personal assessment for the year of assessment 2009/10 will be reduced, subject to a ceiling of \$6,000.
- To extend the concessionary profits tax rate at 50 percent of the normal rate for qualifying debt instruments which have a maturity period of less than three years, and to relax the requirements that such debt instruments should be issued to the public in Hong Kong.
- To allow an accelerated 100 percent tax deduction for capital expenditure on environmentally-friendly vehicles.
- To allow a tax deduction for capital expenditure on purchasing registered trademarks, copyrights and designs.
- The Commissioner of Inland Revenue will further clarify the definition of “central management and

control” to address business concerns on the residency requirement for directors of management committees. This will affect whether offshore funds can claim profits tax exemptions.

- To update the lists of recognized stock exchanges and future exchanges under the Inland Revenue Ordinance so as to extend the application of tax exemptions for offshore funds engaged in future trading.

His proposal relating to other taxes, duties and fees are:

- The rate of stamp duty on transactions involving immovable properties valued over \$20 million will increase from 3.75 percent to 4.25 percent as from 1 April 2010. Buyers will no longer be allowed to defer stamp duty payments on such transactions.
- The stamp duty concession in the trading of exchange traded funds will be extended to cover funds that track indices composed of not more than 40 percent of Hong Kong stocks.
- The waiver of business registration fees will continue for another year, up to July 2011.
- Duty-free concessions on tobacco products for incoming passengers will be abolished. Only small amounts of tobacco products for own consumption will be exempted. A phased increase in tobacco duty will be considered in the future.
- Rates for 2010/11 will be waived, subject to a ceiling of \$1,500 per quarter for each rateable tenement.

T/D

To read the complete article, visit the Learning Centre on our website at www.hkiaat.org/index.php/services/index/199/

HKAS 24 (Revised) - Related Party Disclosures

(Relevant to AAT Examination Paper 7: Financial Accounting)

Dr. M.H. Ho, School of Continuing & Professional Studies, The Chinese University of Hong Kong

Introduction

Since the existence of related parties may result in transactions being completed other than at an arm's length basis, it is necessary to disclose the existence of related parties, and the nature and extent of transactions between related parties. HKAS 24 (Revised) "Related Party Disclosures" is useful in identifying related party relationships and transactions, as well as in determining the disclosures required for these transactions.

Related party transaction

HKAS 24 (Revised) defines a related party as follows:

- (a) A person or a close member of that person's family is related to a reporting entity if that person has control, joint control or significant influence over the reporting entity.
- (b) An entity is related to a reporting entity if one entity is an associate or is controlled or jointly controlled by a person identified in (a).

HKAS 24 (Revised) defines a related party transaction as "a transfer of resources, services or obligations between related parties, regardless of whether a price is charged".

Significance of disclosing related party relationship and transactions

A related party relationship can affect the financial position and performance of an entity under different circumstances:

- (a) Transactions may be entered into with a related party on terms different from those with an unrelated party.
- (b) The existence of a related party relationship may

affect transactions with third parties or other party in the same group.

Disclosure requirements for related party transactions

HKAS 24 (Revised) requires the disclosure of:

- (a) Control
 - the related party relationship, where the reporting entity is controlled by another party
- (b) Key management personnel compensation
 - short-term employee benefits,
 - post-employment and other long-term benefits,
 - termination benefits, and
 - equity compensation benefits
- (c) Transactions and balances between related parties
 - nature of the related party relationships,
 - types of transactions, and
 - outstanding balances and commitments

Conclusion

The steps involved in determining the disclosures required under HKAS 24 (Revised) are:

- identify the existence of related parties and transactions between the reporting entity and its related parties;
- determine whether there are any outstanding balances and commitments between the reporting entity and its related parties;
- consider whether an adjustment is required to rectify any misleading financial position and performance;
- determine the information to be disclosed. **T/D**

To read the complete article, visit the Learning Centre on our website at www.hkiaat.org/index.php/services/index/199/



Modifications to Auditor's Opinion and Auditor's Report

(Relevant to AAT Examination Paper 8: Principles of Auditing and Management Information Systems)

David Chow FCCA, FCPA, CPA (Practising)

Clarified pronouncements

The new HKSA 705 “Modifications to the Opinion in the Independent Auditor’s Report”, aims to provide guidance solely on the modifications to auditor’s opinion and to replace the superseded HKSA 701 “Modifications to the Independent Auditor’s Report”, which provided guidance on both the modifications to auditor’s report and the auditor’s opinion.

HKSA 705: Modification to the auditor’s opinion

In the new HKSA 705, a pre-condition in determining which type of modification to the auditor’s opinion is whether the auditor is able to obtain sufficient appropriate audit evidence. Furthermore, the auditor’s judgment about the nature of the matter giving rise to the modification of the auditor’s opinion, and the pervasiveness of its effects or possible effects on the financial statements, affects the type of opinion to be expressed.

Types of modified opinions

Nature of matter giving rise to the modification	Auditor’s judgment about the pervasiveness of the effects or possible effects on the financial statements	
	Material but not pervasive	Material and pervasive
Financial statements are materially misstated	Qualified opinion	Adverse opinion
Inability to obtain sufficient appropriate audit evidence	Qualified opinion	Disclaimer of opinion

HKSA 706: Modification to the auditor’s report

In practice, there may be circumstances in which the auditor considers it necessary to draw users’ attention to a matter presented or disclosed in the financial statements that is of such importance and is fundamental to users’ understanding of the financial statements. However, such a matter does not affect the auditor’s opinion, i.e. there is no modification to auditor’s opinion. The new HKSA 706 “Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor’s Report” is issued to deal with (i) emphasis of matter, and (ii) other matters.

Common conceptual mistakes

Note that qualified opinion is only one of three types of modified opinion. During the examination, candidates should state clearly whether the modified opinion is an adverse opinion, a disclaimer of opinion or a qualified opinion.

Some old text books used phrases such as “with the foregoing explanation” or “subject to” in the opinion paragraph; these are inappropriate and are not clear expression of the auditor’s opinion.

T/D

To read the complete article, visit the Learning Centre on our website at www.hkiaat.org/index.php/services/index/199/



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Y. L. Yeung & Co.

Opportunities are for those who are well- prepared

Mr. YL Yeung, an equity partner in the solicitor's firm YL Yeung & Co., talks to us about Mandy, his AAT qualified staff member, and discusses what the important attributes of an employee are to him as an employer.

By Foster Yim

YL Yeung & Co. has been operating in Hong Kong for 40 years. The firm was first called L S Shum & Co. in 1970, renamed Shum & Yeung in 1977, and finally took its present name in 1984. The main practices of the firm are civil and criminal litigation, wills and probate, corporate law, and conveyancing. The last category accounts for more than 70 percent of the firm's business.

Employer in the spotlight -

YL Yeung

"Our accounting manager Mandy has been with the firm for nine years. At the beginning, she was pretty much a data entry clerk. However, she soon demonstrated great proactiveness in learning and mastered the specific accounting rules related to the legal profession. So we assigned her more and more responsibilities and eventually she took over the operations of the whole accounting department," says Mr. Yeung.

This promotion did not come about by accident. "Mandy has actively equipped herself with different accounting knowledge particularly The Law Society Accounting Rules Systems. She has been continuously taking accounting examinations from the HKIAAT," Mr. Yeung adds. Even though Mr. Yeung is not very familiar

with the accountancy profession and the professional qualifications, he thinks that Mandy's performance speaks for itself.

"In around 2004, the head of the accounting department asked for a pay rise, when Hong Kong was still badly affected by economical recession and the firm could not afford it. Our profession has several unique special requirements in handling accounts: for example, a clear division of the firm's money and the clients' money; and the need for timely and accurate records of every deal within three days. At that moment, there were only a few choices left to me. Option (a) was to give the then head of the department what she wanted. Option (b) was to hire another experienced accountant from another law firm. Option (c) was to bet on Mandy, who was the assistant accountant at the time, and let her try to head up the department. Option (a), I believe, would not be preferable to any employer. Option (b) may have cost me the same amount of money but without any guarantee that the new accountant would be at least as good as the old one. So I chose option (c). Luckily, Mandy did not disappoint me!" Mr. Yeung explains.

Not only Mandy did not disappoint Mr. Yeung – her performance has always exceeded his expectation. "My impression of Mandy was very positive even before assigning her the new task. But heading up a department and making sure that everything is in line with pre-set rules and regulations is not easy. Our accounts have to be audited by external parties every year. Surprisingly, in the first year of her appointment Mandy made a perfect report, attracting no adverse comments from the auditor. Even an experienced accountant cannot guarantee to make a report that attracts zero negative comments. So the following year I promoted Mandy to be our accounting manager."

"Many employees nowadays believe in doing more for less. But let me tell you, it is not the case. No boss would like to lose a valuable employee for the sake of saving

a penny. But to get a salary rise, you need to prove your value by solid evidence instead of just words!" Mr. Yeung emphasizes.

Mandy has proved her worth through her actions. In Mr. Yeung's eyes, Mandy is a model employee who is serious, willing to learn, and highly reliable. "Whenever she comes across anything which she does not know, she flags the matter and seeks help from her supervisors." Such attitude and attribution was indeed motivated by her studies for the AAT examinations. Students develop by studying for more papers while they take on ever increasing responsibilities at work.

From Mandy's example, it is clear that employers value their staff not merely because of their qualifications but also because of their performance and attitude. The latter is an expected learning deliverable from studying for the ATE and PBE examinations. Mandy successfully developed her attitude through her HKIAAT studies. Will you?

T/D





Versatile AAT Mandy Ngai

Equip yourself stretch yourself to the limit!

Accounting work is demanding as it requires a high degree of expertise. Accounting work in a law firm requires something extra; accounting personnel there not only have to comply with normal accounting standards but also with the stringent rules on solicitors' accounts. Through her hard work and diligence, Mandy Ngai, a Professional Bridging Examination graduate who is now the accounts manager in a law firm, proves her value by applying the knowledge she gained from the HKIAAT examinations to her work.

By Foster Yim

Mandy Ngai entered the legal field by chance when she started work as an accounts clerk in a solicitors' firm in 2001. She studied for the Accredited Technician Examination (ATE) in 2002. She found the syllabus very practical. While it is clear why the taxation and business law syllabuses were useful, Mandy found the material on IT applications in accounting helped a beginner like her understand how to use accounting software in handling daily accounting tasks. The auditing syllabus helped her understand

the rationale for having stringent rules and regulations in the legal profession. For example, a large portion of the business in the firm she works for is related to conveyancing, or property transactions. In Hong Kong, time is of the essence: the slightest delay in payment can lead to a contract being repudiated. It is therefore extremely important that assignment cheques are paid on time – a point that accountants who are not familiar with the special rules governing legal accounting may fail to appreciate.

Accounting for the legal profession includes two extra sets of requirements that are unique to this profession – Solicitors’ Accounts Rules and measures to be taken against money laundering – which accountants have to comply with. That is why legal accounting sounds so challenging to many in the accounting profession, including experienced practitioners in large accounting firms.

Mandy has always been eager to improve herself through work and in study, and so she has familiarized herself with the legal accounting rules with the help of her boss, Mr. Yeung. She has also become highly skilled in different accounting standards and requirements through her studies for the HKIAAT examinations. In recognition of her contribution to the company and her professional development, her employer promoted her to the accounts manager in 2005. She finished all the AAT Examination papers a year later. “I continue to find the knowledge I gained through studying for the AAT Examination to be very helpful in my job. Recently, my firm needed to open a branch. The knowledge that I gained from the AAT Examination helped me a lot in setting up the new branch. Now, I apply the knowledge gained

from the AAT Examination in consolidating the accounts from the branch and head office,” says Mandy.

With her appreciation of the usefulness of the AAT qualification, Mandy started studying for the Professional Bridging Examination (PBE) in 2007 and successfully completed the exams within two years. Today’s harvest is a result of yesterday’s hard work, Mandy notes. “Unlike studying for a degree programme in university, taking ATE and PBE are lonely tasks. It is easy to be distracted and it is easy to lose steam. One needs to be highly disciplined. On the other hand, ATE and PBE are affordable and flexible study options. In the near future, I hope to finish the Hong Kong Institute of CPAs Qualification Programme as soon as possible and become a Certified Public Accountant.”

Though she is still not yet a CPA, Mandy possesses specific knowledge related to legal accounting which gives her an edge over others. “If I can do it, you can do it! The key is whether you are willing to learn. And I have found the HKIAAT to be really helpful in the process involved.”

T/D

Mandy Ngai’s study and career path

Graduated from F.5	1998
Certificate in Secretarial & Computer Studies – Sacred Heart Canossian College of Commerce	1999 – 2001
Undertook and completed the Accredited Technician Examination (ATE) (with an exemption from one paper)	2002-2006
Undertook and passed the Professional Bridging Examination (PBE)	2007-2009
Accounts Clerk / Accounts Manager – Y L Yeung & Co. Solicitors	2001 – current



Passport to success-

Jasmin Yim

Every little step leads you to great achievements!

Through the articulation pathway provided by the HKIAAT, Jasmin Yim earned her CPA and became an assistant financial controller just under a decade through her great efforts and persistence. Without taking the first steps in the past, she says, you cannot expect to be successful today.

By Foster Yim

When Jasmin Yim first left school and started to study for the AAT qualification, she never dreamt that she would reach the position she is in today: a CPA and the assistant financial controller of East Channel Holdings Limited.

“After Form Five, I studied the Advanced Certificate of Accountancy at the Kwun Tong Vocational Training Centre of the Hong Kong Christian Service. However, I felt the need to have a recognized qualification. That’s how I started my professional journey!” says Jasmin.

Jasmin opted for the AAT qualification because of its flexibility and cost effectiveness. “I was granted an exemption from three papers in the AAT Examination on the merits of my advanced certificate. This was an absolute advantage which other professional qualifications could not provide. Why didn’t I opt for a degree? I found the AAT pathway to be more flexible and affordable for students like me. It was a kind of risk management as well. By following this pathway, I would never be deprived of the chance of gaining valuable experience from work,” Jasmin explains.

After graduation, Jasmin joined K. Wah Construction Materials Limited, working as an accounts clerk for three years. She moved to her present employer in 2000. Her career advanced in parallel with her studies. Jasmin took two years to finish the AAT Examination, another two years for the Professional Bridging Examination (PBE), and four years to become a CPA under the Qualification Programme (QP). In the meantime, she was promoted from

assistant accountant to accountant, and then to assistant financial controller.

“Even though studying and working are two different things, what I learned from the AAT Examination and PBE planted a solid foundation for me, equipping me to respond quickly to new challenges. For example, in my old company, I wouldn’t have had the chance to deal with consolidated accounts due to the single nature of the company’s business. My present employer, however, is a holding company with a wide variety of subsidiaries. We have businesses in logistics and raw plastic processing; we also have a few factories in mainland China. I couldn’t have picked up consolidation skills so quickly if I had not had the AAT qualification,” Jasmin says.

“Another example of the usefulness of the AAT qualification relates to standards compliance. After I was promoted to the post of assistant financial controller, I started to appreciate the concepts and theories I had learned from my studies. In handling taxation issues and preparing financial reports, I need to cast a close eye on different legal and compliance requirements. Otherwise, the consequences could be very serious.”

Higher job titles bring more serious responsibilities, and different sets of considerations. As part of the management team, Jasmin has direct access to the group’s boss. She needs to deal with different external parties, such as bankers and big clients. She also needs to be familiar with the group’s operational process and to maintain good communications

with colleagues from all departments. These are quite different responsibilities from those she had in her former duties as an assistant accountant or accountant.

Preparing a student’s transition from being a skilled technician to manager is the very essence of the PBE, thinks Jasmin, even though this transition time was not easy for her. “I had just got pregnant when I finished the PBE. The part-time study route is lonely. I had thought of giving up. However, I didn’t want to waste all my previous good efforts, so with the support of my husband and my employer, I stayed on. Even though the pace of my career progression may have been different from that of a degree holder, little by little, step by step, I made it my way. I have the following sincere advice for other people like me – don’t underestimate your achievements with every little step you take in your career; with persistence, they all add up to lead you to great things!”

T/D

Jasmin Yim study and career path

Graduated from F.5	1995
Advanced Certificate of Accountancy – HKCS Kwun Tong Vocational Training Centre	1995 – 1997
Accounts Clerk – K. Wah Construction Materials Ltd	1997 – 2000
Undertook and passed Accredited Technician Examination (ATE) (with exemption from three papers)	2000 – 2002
Undertook and passed Professional Bridging Examination (PBE)	2003 – 2005
Completed Hong Kong Institute of CPA Qualification Programme (QP)	2005 – 2009
Assistant Accountant / Accountant / Assistant Financial Controller – East Channel Holdings Ltd	2001 - current

THE GUT TYPES - 8, 9 & 1

OF THE ENNEAGRAM

Anybody can become angry, that is easy; but to be angry with the right person, to the right degree, at the right time, for the right purpose, and in the right way, that is not within everybody's power – that is not easy. (Aristotle)

In this last discussion, let's look at the last typology group, the Gut Type, 8, 9 and 1. Let's consider the following demonstration of their characteristics.



Kate, the marketing director, leads major projects that contribute substantially to the company's turnover. Her executives are "loyal followers". One morning, she charged into the Finance Department holding the expenses claim made by Linus, one of her executives. The financial controller had rejected the claim for lack of justification. Kate's voice was loud and intimidating. Without concern for others' feelings, she blasted out: "Without incurring this expense, Linus could not have closed this



deal! Linus has every reason to be reimbursed!" She let out her steam at Wanda, the financial controller. "Either you sign the claim now, or the general manager will." Kate is a No. 8, the Challenger (sometimes known as the Leader). She is full of fire. Her determination and energy have brought her success and she is proud of her energy and her forcefulness. Her inner voice is: "I am never wrong. Who dares say I am wrong? You'd better have valid reasons. My mercy is not for timid people. Show me your guts!"

With everyone in the Finance Department watching, Linus, who was hiding behind Kate, was looking very embarrassed. With his quiet voice he seemed so helpless listening to Kate roaring over a small matter like this. Though he appreciated Kate taking up the matter for him, he would rather have a peaceful resolution to this. He was never a forceful or assertive type. His heart was pounding with guilt and shame. He blamed himself for creating this embarrassing situation. He wished he could hide. He blamed himself for this situation even though Wanda's rejection of his expense claim had bothered him for weeks. He just wanted to avoid the matter. He knew Wanda was a very strict person and she was hard to face. On the verge of giving up, he decided to let Kate handle the matter. Linus is a typical No. 9, the Peacemaker.

Wanda, the financial controller, has seen many types of expense claim abuse. She is proud to be the gatekeeper safeguarding the company's assets. Her motto is: "All bugs stop here!" She is well known for her

principles and her steadfastness as financial controller. To demonstrate her integrity and her determination, she is ready to reject anything that does not match her definition of proper documentation. She has high standards and she is a perfectionist, a No. 1. “When something is worth doing, it is worth doing well,” she always says. Her subordinates are well disciplined and have learned a lot from her. How could they not? She stood up to Kate with a stern face and was ready to fire back. Linus wanted peace. Kate was ready to charge.

The Enneagram framework gives us insight into office politics. With it, not only can we recognize the human factors at work, but we can also make use of these factors to bring about a resolution to problems. The unwanted help that the No. 2 Helper so readily offers is made complicated by a competing No. 3 Achiever, and worsened by an emotional No. 4 Romantic. When consolation and empathy is outrageously absent in the No. 5 Observer, and the No. 6 Loyal friend is too timid to say the right thing, this gives the No. 7 Epicure the perfect excuse to escape from the situation. The impulsive No. 8 Challenger will run over everyone like a tank in order to be a “good” leader regardless, while the No. 9 Peacemaker shies away from any confrontation, leaving the No. 1 Perfectionist demanding a perfect ending that not many can live up to. With these dynamics going on, how can office discipline and teamwork be put to work?

Understanding your own core values and the worldview of the personality types you belong to is the first step to breaking through the limitations in which you are currently trapped. Appreciating the core values and worldview

of your team members is the first step towards effective teamwork. You owe it to yourself to become a better person, and to your team to make a better team. The Enneagram provides a simplistic tool to do both. It is a liberating tool that provides choices. You discover the truth about yourself and others by understanding the schema that directs life. The Enneagram invites people to grow out of their limitations. One way to do that is by choosing to be humble, to accept the shortcomings of all personality types, and to be mutually encouraging. This opens up possibilities, and provides us with the courage to accept challenges and tolerate pain from the shortcomings of those holding different core values from our own. When we deal with our shortcomings and resolve our conflicts with others, we transform ourselves into someone who is capable of learning from others. Reading books, going to relevant personality workshops and practicing as we learn are good ways to breakthrough uncertainty.

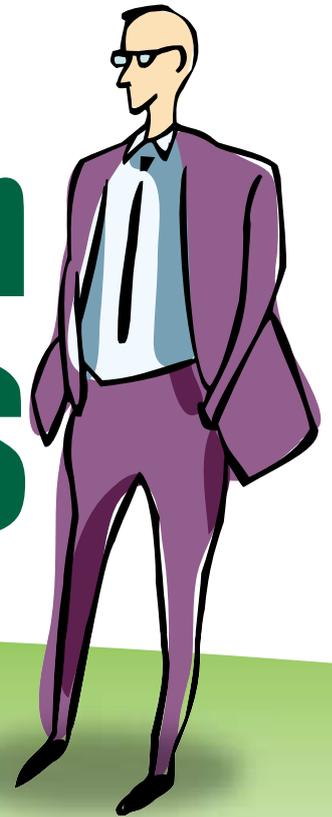
If you are considering changing employment because of personality crashes, think twice. The fact is that, wherever you move to, you will still bring your own personality with you. Why not let “The bugs stop here” and start transforming yourself? The only person who can bring about any change to yourself is you. It takes great courage and wisdom to accept that. Do you have both? Transformation follows. **T/D**

William Tong is a professional accountant. He specializes in executive coaching and training in management soft skills. His expertise includes strategic planning, setting goals, and making things happen. He delivers cultural changes and helps people to excel in life. He can be reached at wtong@transformation.com.hk



Negotiation Skills

By Weelan Ho



What is negotiation?

Negotiation is a basic means of achieving what you want from others in a manner that is mutually beneficial. It is a back and forth communication designed to reach an agreement when you and the other party have certain shared as well as certain opposing interests.

Negotiation traps

Misconceptions about negotiation lead to people taking positions and therefore falling into the trap of being either a hard or a soft negotiator, or somewhere in between (see figure 1).

- A hard negotiator is often aggressive, wants to win, positions each situation as win-lose, with hard responses that exhaust him and others and ultimately harm the relationship.
- A soft negotiator tries to avoid conflict, concedes easily to reach an agreement quickly, often at his disadvantage.

Taking a position and its consequences

Negotiation by position is when you take a stand which you believe serves your interests best

and subsequently lock yourself into the position irrespective of the other party's interests and concerns. Consequently:

- The more you clarify the position, the more you defend it and the more you become committed to it.
- It becomes harder to change your opening position.
- Your ego becomes identified with the position – it becomes a “face” issue.
- This further complicates matter. You now have a new interest in “saving face” – in reconciling future actions with your past positions.
- The agreement may not be objective based.

Negotiation techniques are based on preparation, discussions, propositions, and bargaining. You give in some, I give in some. Often the hard negotiator wins.

An alternative approach – negotiation by merit

Taking positions often lead to a win-lose

situation. A more constructive and rational approach is to look beyond position and to focus on interests. This is negotiation by merits, as first proposed by Roger Fisher and William Ury. The negotiated agreement is based on mutual interests supported with facts, objective criteria and rationales. It is a form of collaborative problem solving satisfying each party's interests based on their underlying needs.

Negotiation takes place at two levels:

1. The substance
2. The procedure dealing with the substance

For example

The first level is concerned with the content, the objective substance such as salary, lease, the price to pay, etc. The second level is concerned with how you will negotiate the substance, i.e. the procedure dealing with the substance – the way you handle the negotiation and thus the relationship.

Negotiation by merit – the four elements

The four elements defining a negotiation are people, interests, options and criteria.

Separate the people from the problem

Do not try to solve people problems with substantive concessions. People problems can be problems dealing with perception, emotion or communication. Deal directly with problem but do **not** resolve it through substantial concessions. Therefore:

1. Where perceptions are inaccurate, look for ways to educate
2. If emotions run high, find ways to enable each person let off steam to defuse the situation

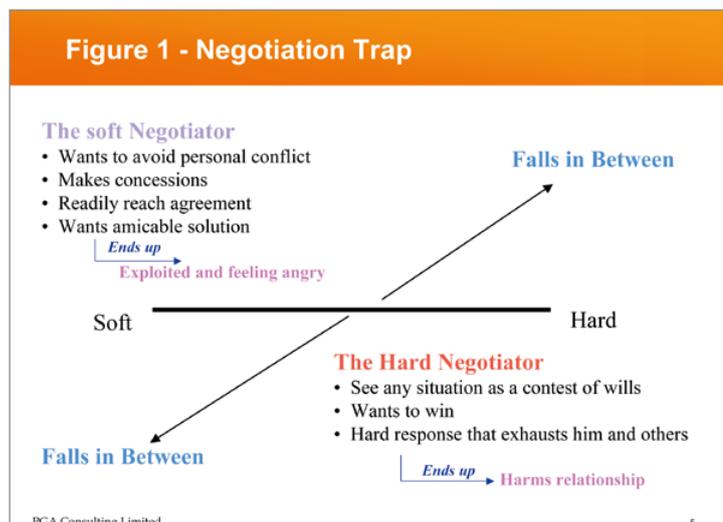
3. Where misunderstandings exist, work to improve communication

In negotiation, we must deal not only with the other party's people problems, but also our own. We can be our biggest barrier to success. Our anger and frustrations sometimes work to obstruct an agreement that is beneficial to both parties.

Prevention works best. The best time to handle people problems is before they become people problems. This means building a personal relationship and an organizational relationship with the other party. The best working relationships are built on trust. Face the problem, not the people. You are **partners working side by side** towards an agreement. You are not adversaries. The basic approach to separating people from the problem is to deal with people as human beings, according them with the respect expected, and to then treat problem on its merits.

Focus on interests, not positions

Interests define the problem. For every possible interest there are usually several possible solutions that can satisfy each



particular interest. Too often, people opt for the obvious solution. It is important to find out the underlying needs and motivation by asking “why”, and to ask “why not” to understand the reasons behind the argument.

It is imperative to recognize that each negotiator may have multiple interests which needed to be taken into account – these include his own interests, and those of his direct boss, subordinates, organization, and so on.

In negotiation, make a list of the other party’s interests. Write them down so that you remember them. Furthermore, this may stimulate ideas on how best to meet these different interests.

Invent options for mutual gain

Expand the pie before dividing it – find creative solutions that are advantageous to both parties. Don’t be limited by your own mindset. Brainstorming is a good way to invent options. It is beneficial to have joint problem solving approach to generate trust, to help each party understand each another, and to create a better buy-in as both sides are parties to the solution.

Four major obstacles that inhibit the inventing of options in a negotiation are:

1. Making a premature judgement – exhibiting bias, prejudice, and a “no or this cannot be done” mentality.
2. Searching for a single answer.
3. Assuming there is a fixed pie.
4. Thinking that solving the issue is the other party’s problem.

In inventing options, it important to:

- Separate the act of inventing options from the act of judging them, i.e. suspend judgement while inventing options.

- Broaden the options rather than looking for a single answer.
- Search for mutual gains.

Stressing your shared interests can make negotiation smoother and more amicable. Developing solutions that are based on precedents or objective criteria and standards makes it easier for both parties to accept them.

Insist on using objective criteria

Establish fair standards that are legitimate and practical, and that are independent of will and bias. You can have fair standards for substantive issues, and fair procedures for resolving conflicts (i.e. handling relationships). Three steps to establishing objective criteria and standards are:

1. Frame each issue as a joint search for objective criteria to derive a consensus on the rationale and principles of what is fair.
2. Discuss, reason, and be open to reason and discussions as to which objective criteria or standards are the most appropriate and how they apply.
3. Yield to principles, not pressure.

With objective criteria supported by principles, negotiations are more rational, particularly when we separate any people problems from the issue concerned. The process also becomes richer because it allows for flexibility based on interests and encourages creative options that are mutually beneficial – a win-win situation based not on position but on mutual interests.

T/D

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