

EFFECTIVE MANAGEMENT: IDEAS & PRACTICE

November 13, 2015
Bishkek, Mazars



TOPICS FOR DISCUSSION:

- Internal control informally
 - Practical advantage
- Budgeting
 - Practical advantage
 - How?
- Tax structuring
 - Offshore zones from tax perspective
 - Case studies
- Questions & answers session, discussion



MAZARS: KEY FACTS IN NUMBERS

Our employees

15 000

around the world

73

integrated countries



Key figures for the year 2013-2014

1,1 bln €

revenue

+5,8%

growth rate



Our rating

5

Auditor of the European largest public companies



Alliance Praxity enables to operate

in additional 29 countries

with more than 35 000 professionals

MAZARS IN KYRGYZSTAN: SPECTRUM OF SERVICES



MAZARS IN KYRGYZSTAN

Mazars Shared Service Center on Accounting in CIS: Clients

FRANCE TELEVISION

MEADWESTVACO

PODEMCRANE

SIT CONTROLS

SIT VOSTOK

ZILLI

ASROCK

CEGIS

ACCURAY

BOOKING.COM

DELIFRANCE

EIRICH

FATER

BORD BIA

IDIADA

RLG

ARCHITECTURE STUDIO

GEOTECHNOLOGIES

CHEMTURA

ARCELOR

SOC 24 RUSSIA

FORTINET

IB OPERADORA

NEXIRA INTERNATIONAL

NITTO

NTN SNR

ORCHESTRA PREMAMAN

TAG HEUER

U-POL

ACTEON

ATOS

HAMILTON

COOPERL

CORSAIR

FIVES LILLE

DIM

LORD

MTLZ

CAMUS

SNOP RUS

BIOMERIEUX

VINCI

SABENA

ACCOR S.A.

STALLERGENES LLC

AKKA TECHNOLOGIES

LLC

TRAVEL CHANNEL LLC

WAYFARER LLC

ANOTECH

LONGCHAMP

V33

FABERNOVEL

VALODE AND PISTRE

EDELMAN

VIRBAC

VM-RUS

ARYSTA LIFESCIENCE

BEICIP



01

Internal Control

Enron Case

History

- In 2000 Enron had annual revenue of **\$111 bln.**
- Enron used to be one of the world's major energy, natural gas, communications, and pulp and paper companies.
- Company management headed by CEO had concealed billions of dollars from failed deals and projects using creatively planned accounting fraud, manipulating financial statements and creating SPVs.
- In December 2001, Enron filed for bankruptcy.



Enron Stock Price from August 23, 2000 to January 11, 2002



Consequences

- **Sarbanes-Oxley Act (SOX)** significantly tightens control and requirements to the financial statements and to the process of its consolidation.
- For assurance purposes SOX obliges company's CEO and CFO personally to sign all financial statements, imposing them to legal and criminal liability.
- **The Committee of Sponsoring Organizations of the Treadway Commission (COSO)** published "Internal Control Framework".
- COSO developed general internal control model, which enables companies to compare it with their own internal control management system.

INTERNAL CONTROL

- 1. What does internal control system mean?**
- 2. How to build internal control system?**
- 3. General recommendations on effective control**

What is internal control system?

Strategic goals and tasks



Internal control system

1. Control environment

2. Risk management

3. Control procedures

4. Information & Communication

5. Monitoring



Result

- Economic efficiency and effective achievement of strategic goals
- Assets preservation
- Reliability of financial statements
- Compliance with legislative requirements

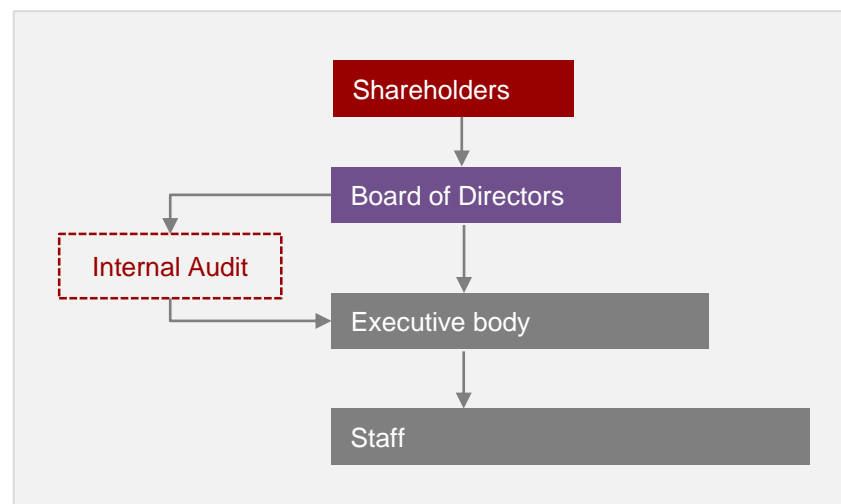
Step #1: Control environment

Control environment is a set of policies fundamental for internal control system, which:

- Arranges proper segregation of duties
- Protects internal discipline
- Provides with high level of ethical norms, personal and professional standards

Mechanisms used to create control environment

- Establishment of corporate governance principles
- Optimization of organizational structure
- Determination of internal processes
- Budgeting
- Implementation of KPI
- etc.



Step #2: Risk Valuation

Risk – any occasion/action which:

- on occurrence, can negatively affect achieving Company`s goals
- can prevent successful realization of strategy



Step 3: Control Procedures

Control procedures –

- policies, procedures, measures and actions enabling realization of management directions, aimed at risk managements and risk minimization

Stages:

1. Definition of goals and tasks
2. Risk identification and valuation in business processes
3. Establishment of control procedures

IMPORTANT

1. Process determination
2. Control procedure must leave trace

Characteristics

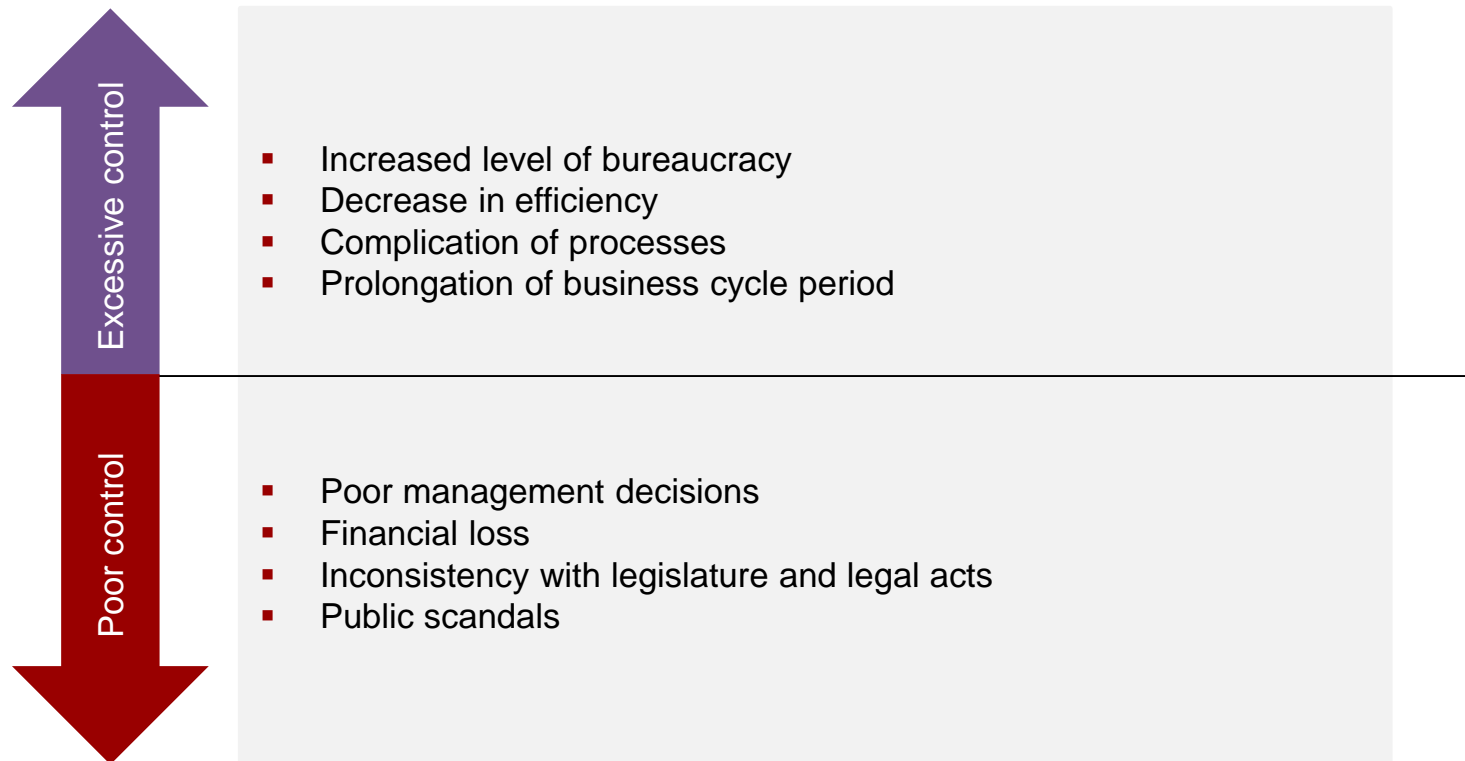
- Preventive / detective
- Manual / Automatic / IT dependent

Standard control procedures

- Compliance, authorization, verification, sanctioning
- Reconciliation among counteragents, reconciliation among systems
- Operations/efficiency analysis
- Inventory count
- Segregation of duties
- IT controls

General recommendations

- **The level of implemented control is subject to management`s professional opinion**
- **Cost of establishing control procedures should not exceed its benefits**



Case #1: Defective structure of corporate governance

Description of situation

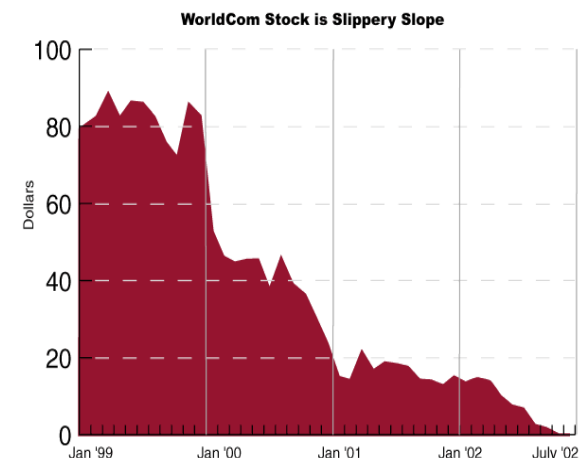
One of the largest corporate frauds in the history is entitled to the whilst giant of telecommunications services WorldCom. It was valued **\$150 bln.** Dishonest CEO and CFO conspired to reverse entries in the general ledger, reclassifying short-term obligations to long-term capital expenditures. As a result, the profit was overstated by \$11 bln..

Risk

Management conspiracy to distort company's earnings.

Solution

- Modifying structure of corporate governance: instituting subordination of internal auditors directly to Board of Directors.



Case #2: Inadequate control in sales process

Situation Description

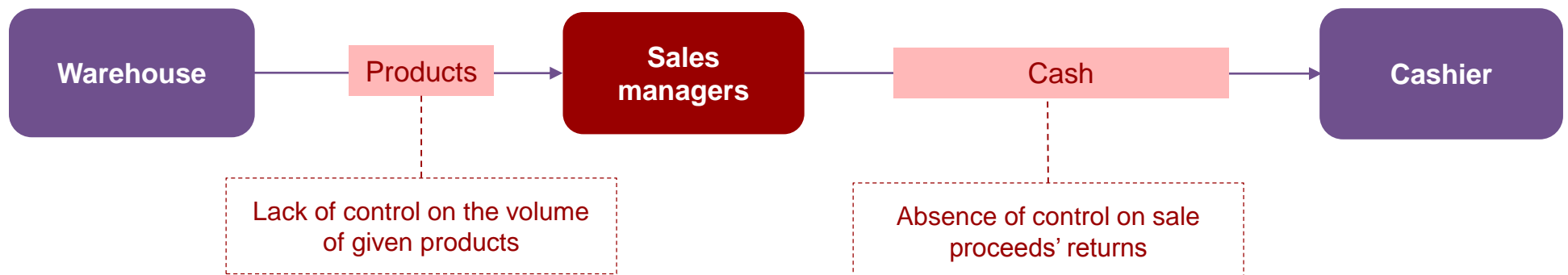
Sales Managers collect products from the warehouse and don't deliver sale proceeds and sales reports timely to cashier.

Risk

- Theft of funds
- Misrepresentation of information on sales for the period
- Increase in accounts receivable of employees

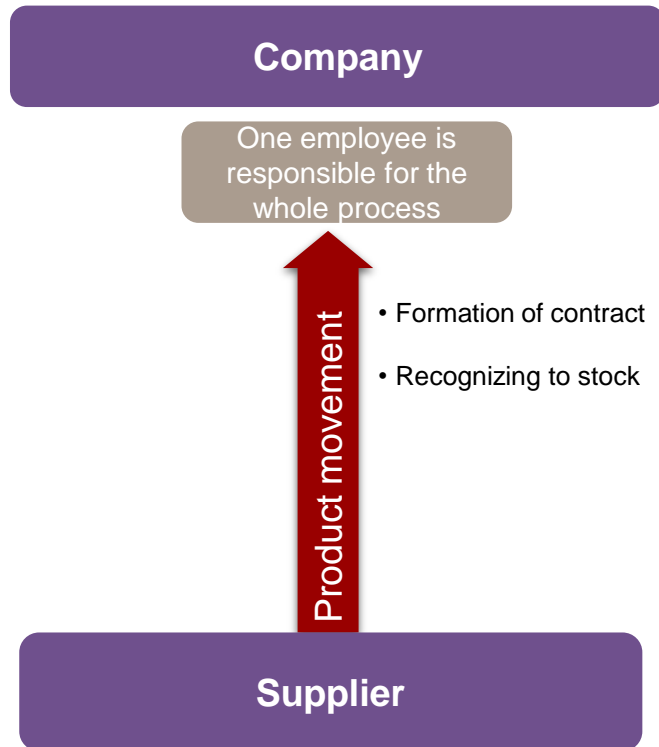
Solution

- Establishment of debt ceiling
- Establishment of deadline for delivery of sales proceed to the cashier.



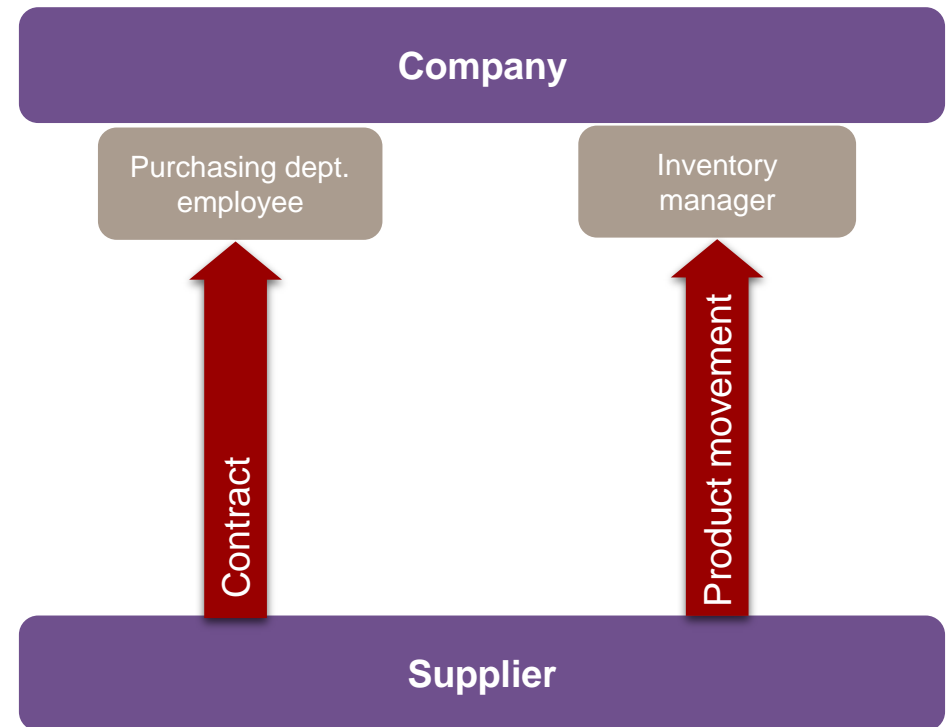
Case #3: Lack of control in sales process

Current Situation



Risks: Conspiracy with supplier on issuance of deceptive documents for a larger amount of products, while recognizing to stock less

Problem Solution



Solution:

1. Inventory manager –materially responsible person
2. Inventory manager compares the amount of products in the order form with contract from the Purchasing dept. and with the amount form the invoice

Case #4: Lack of policy on money resources management

Description of situation

Company cashier issues cash orders and handles all cash operations.

Risk

Theft of cash

Solution

- Segregation of duties— accountant issues cash orders and cash receipts, cashier handles cash.
- Establishment of policy on money resources management
 - ✓ Adoption of daily minimum cash balance in cashier's office
 - ✓ Daily submission of excess cash to the bank



General recommendations

1. Internal control system should be built on Company's goals and risks, which can prevent goals' achievement
2. Effective internal control system doesn't guarantee 100% goals' achievement, but it does provides with adequate confidence in it
3. The cost of establishment of internal control system shouldn't exceed the benefit
4. The responsibility for the effectiveness of internal control system relies on the whole staff collectively



02

Budgeting

Case #1

Description of situation

Significant amount of time top management spends on daily operations

Risk

“Time trap” for the CEO

Solution

Delegation of duties and responsibilities to the lower levels of management by defining tasks and responsibilities within their departmental budget framework



What is budgeting?

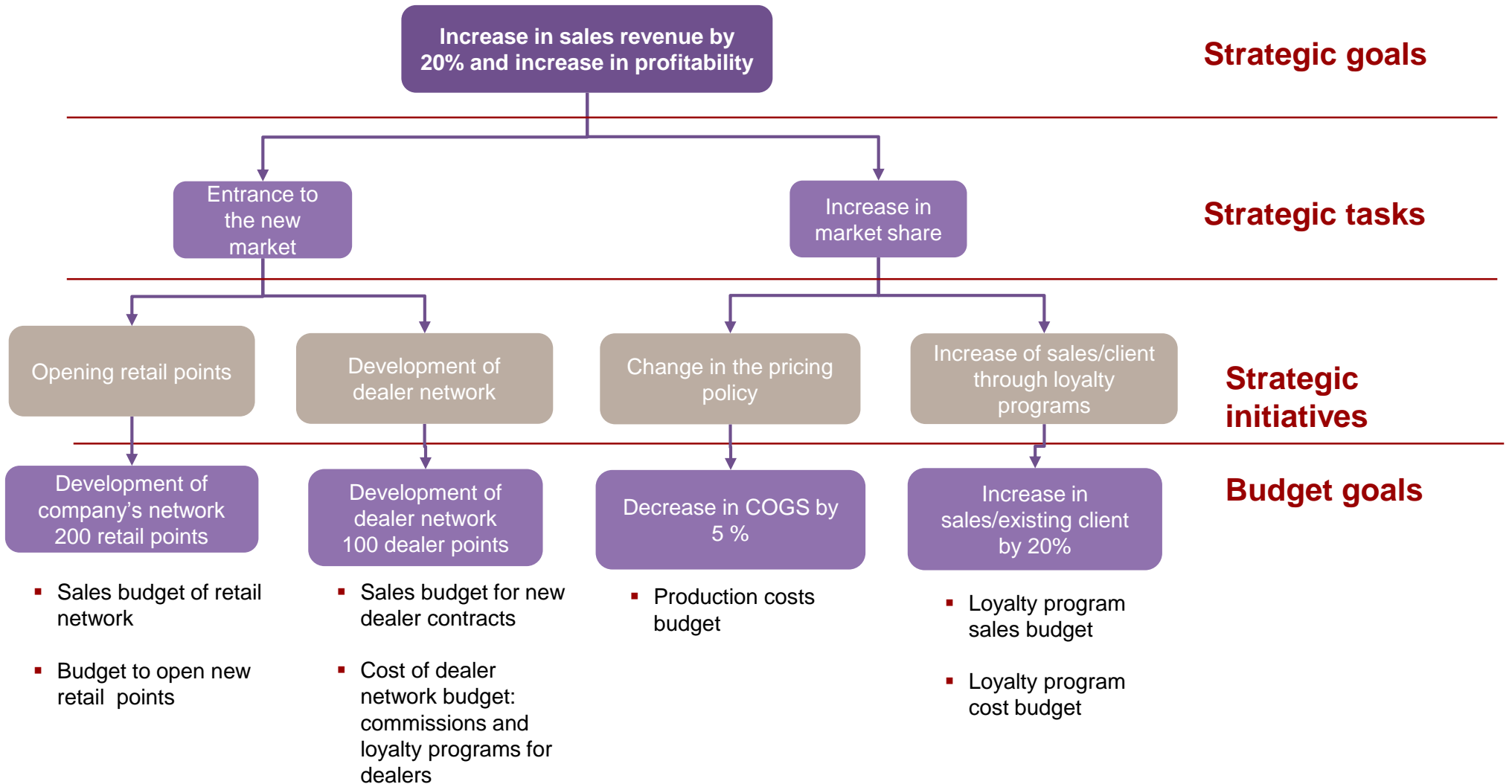
Budget management (budgeting) - system of company's operations management by responsibility centers, which are subject to the budget. Budgeting enables goal achievement using resources in the most efficient way.

**Efficient allocation of
resources**

**Delegation of
responsibilities**

Achievement of goals

How to identify the right goal?



Who is responsible for the budget?

CFR: Investments	<ul style="list-style-type: none">• CEO
CFR: Profit	<ul style="list-style-type: none">• CEO
CFR: Revenue	<ul style="list-style-type: none">• Commercial Manager
CFR: Costs	<ul style="list-style-type: none">• Productions Manager• Administrative Manager• CFO
CFR: Marginal Revenue	<ul style="list-style-type: none">• Manager of business line

Company financial structure is a system of various centers of financial responsibilities structured hierarchically.

Centers of financial responsibilities (CFR)– divisions or a group of divisions, which can directly affect profitability, as well as take responsibility in front of the management for the realization and keeping of the costs levels within the set limits.

Correct definition of the financial structure is a key factor in effective budget implementation process.

Where to start , if you need to incorporate budgeting process?

Define the financial structure of the enterprise

Financial structure- mechanism of segregation of duties for the economic markers.

- At this stage, we define **WHO** is responsible for **WHAT**

Create budget structure

Budget structure –is a hierarchy of revenue budget and cost budget sections as well as separating budget elements among sections, mentioned above.

- At this stage, we provide **COMPLIANCE** of budget items with facts

Formulation of budgeting procedure

Budgeting procedure- Order of preparation, Introduction, compliance of budget, execution of plan/fact analysis and assessment of the budget outturn

- At this stage, we assign **RESPONSIBILITIES** and set **DEADLINES**

Implementation of budgeting system

CASE #2

Description of situation

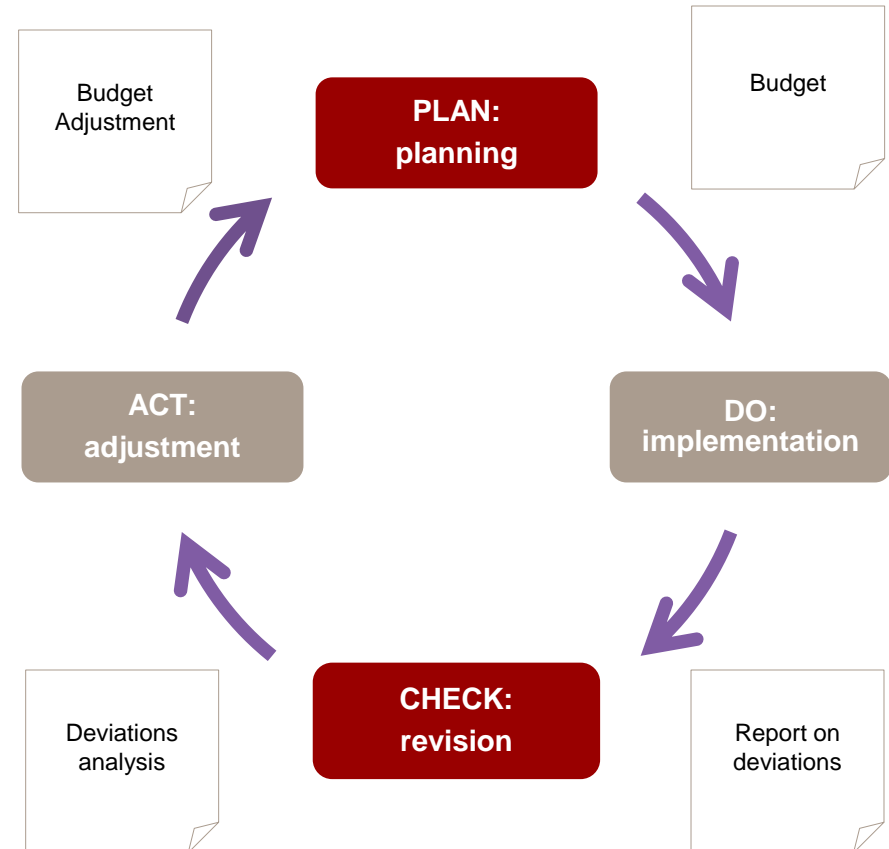
Company budget turned into solely formal document, which only gathers dust after its formation.

Risk

Goals, set in the budget are not reached.

Solution

Periodical analysis of budget implementation during the year, adjustment of certain goals.



CASE #3

Description of Situation

Budgeting process is taking too long.

Risk

Benefits of budgeting process are significantly eliminated by the time spent on budgeting.

Solution

Incremental budgeting – formulation of budgets based on practical results reached in the previous period.

Correct definition of tasks – shrinkage of budget correction cycle.



CASE #4

Description of situation

Employees copy previous period's goals, which doesn't reflect the present strategy of the company.

Risk

Performance within the current budgeting process does not steer to achievement of set goals.

Solution

Zero-Based Budgeting – planning method, which makes managers to justify budget figures every period, as if activity has never been practiced before.



CASE #5

Description of situation

Employees set soft targets.

Risk

Budgeting process doesn't steer to efficiency, but instead negates it.

Solution

Benchmarking – process according to which, company evaluates its products and services against those of competitors, top-ranked large companies, recognized as leaders in the industry.



CASE #6

Description of situation

Market situation changes very fast, therefore budget is losing its actuality.

Risk

Lost actuality of budget.

Solution

Rolling budget – planning process, according to which the period is divided into several stages, upon the completion of each stage budget is rolled on same stage length forward.



CASE #7

Description of situation

Budget results are not complied with actual information from financial accounting.

Risk

Inability to compare budget and actual figures leads to lack of budget implementation control.

Solution

Developing budgeting structure which will enable budget items to comply with financial accounting items.



CASE #8

Description of situation

Upon the pursuance of plan/fact analysis, it was clear that the budget had been exceeded long ago

Risk

- Inability to provide budget implementation
- Occurrence of extraneous expenses

Solution

- Immediate accounting of all actual expenses on all budget items
- Reconciliation of residual balances of assets on different items



Conclusion:

Budgeting – effective management tool

1. PLANNING

- Assigning priorities while allocating limited financial resources

2. INFORMING

- Compliance of employees' actions with company goals

3. DELEGACY

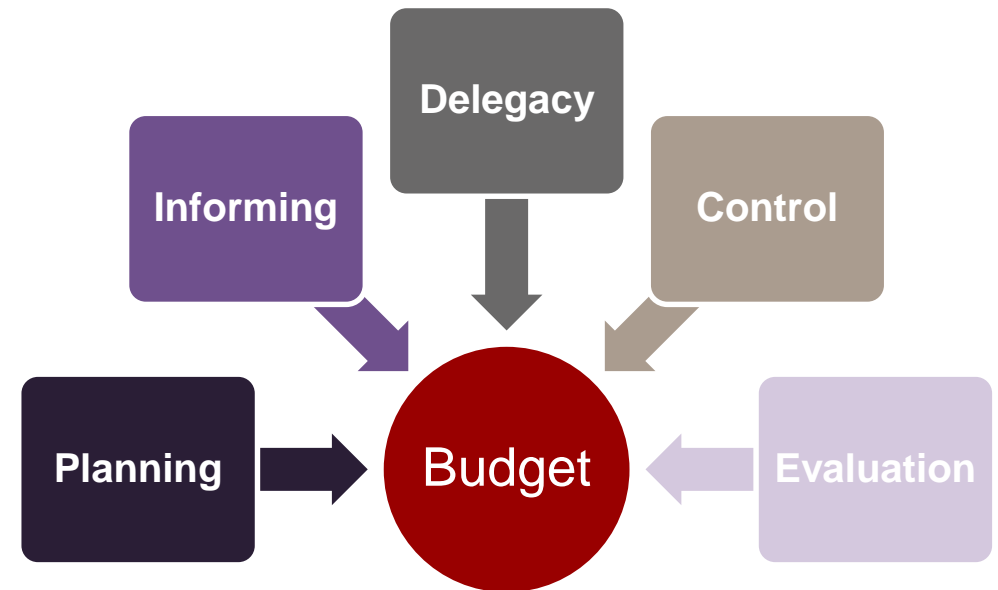
- Release from the “time trap”

4. CONTROL

- Avoidance of ineffective expenses

5. EVALUATION

- Evaluation of effectiveness based on goals reached





03

TAX STRUCTURING

OFFSHORES –WHY?

Extract of public information from www.tazabek.kg

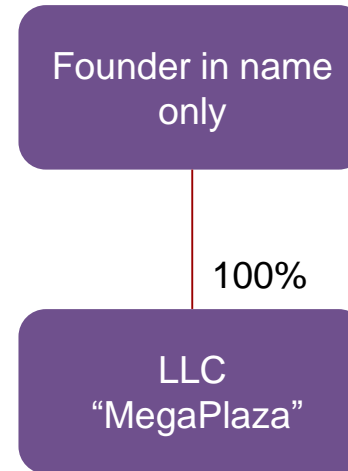
Company	Shareholder
LLC “Tip-Top”	Alieva Larisa Yasynovna
LLC “Expotransfinance”	Nikolaenko Galina Fedorovna
LLC “Beles KG»	Askaliev Mirbek Boslulovich
LLC “Umut & Co”	Abdullaev Kairat Turdadjievich
CJSC “Ursus”	Kadyrkulov Inskender Anarbekovich
LLC “Eletsut”	Aknazarov Almazbek Korchubekovich
LLC “Ice Queen”	Hernandez Rodriguez Xavier Antonio
LLC “Alkomir”	Petrenko Nina Pavlovna
LLC “Garling”	Chukreev Nikolay Aleksandrovich
LLC “Duty Free international”	Djumalieva Mira Duyshenbekovna
LLC “”Winemaker Bishkekwinecom”	Abdykerimova Yrysbubu

OFFSHORES - WHY?



Disadvantages:

- ▶ Publicity of the ultimate beneficiary
- ▶ Lack of security in front of the government entities



Disadvantages:

- ▶ Risk of losing business

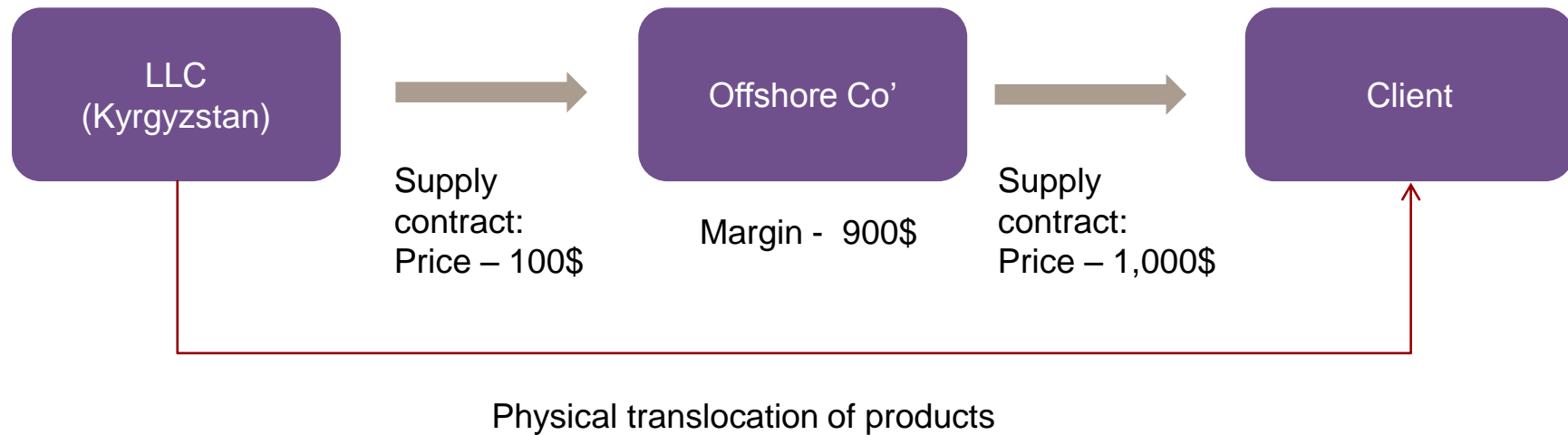
OFFSHORES –WHY?

- ▶ Confidentiality/anonymity of ultimate beneficiary owner
- ▶ Opportunity of tax optimization
- ▶ Financial stability
- ▶ Opportunity to attach card to the bank account

TYPES OF OFFSHORES

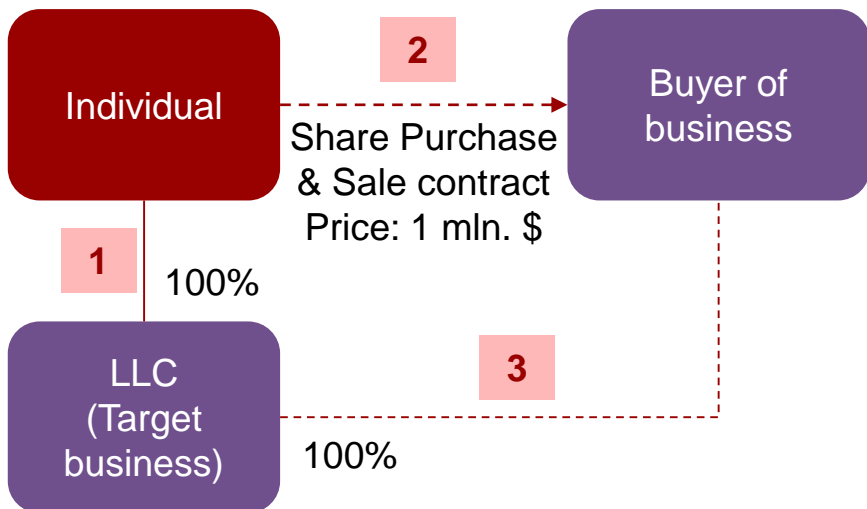
Types of offshore zones	Main characteristics	Examples
Classical offshore	<ul style="list-style-type: none"> ▪ No taxes ▪ No accounting reporting ▪ No registry of shareholders, management ▪ High level of political stability ▪ Very high level of confidentiality 	<ul style="list-style-type: none"> ▪ Belize ▪ British Virgin Islands ▪ Seychelles Islands ▪ The Isle of Man ▪ ▪
Countries with low taxation regulations	<ul style="list-style-type: none"> ▪ Low tax rates ▪ Relatively “simple” reporting ▪ Registry of shareholders, management ▪ Annual audits – goal: to prove the absence of business activities within the offshore territory 	<ul style="list-style-type: none"> ▪ Cyprus ▪ Malta ▪ Luxembourg ▪ Holland ▪ Switzerland ▪ Latvia ▪ Hong Kong
Pseudo-offshore	<ul style="list-style-type: none"> ▪ Low tax rates for the companies with special forms of legal entities or due to the location 	<ul style="list-style-type: none"> ▪ USA, Delaware ▪ Great Britain ▪ Canada ▪ UAE, Ras al-Khaimah emirate

Making use of offshore: Case #1 - Export



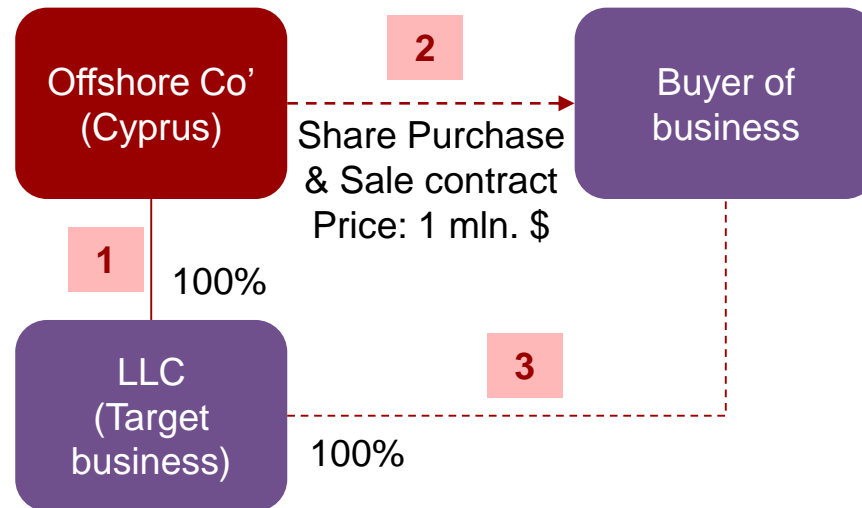
Information above is presented only for the general knowledge reason, it is not legal or professional advice

Making use of offshore: Case #2: Selling a Company



Result: Income tax – 100,000\$

Common practice: Selling for 10 000 KGS, the remainder is transferred with high level of risk



Result: Capital gain tax – 0%

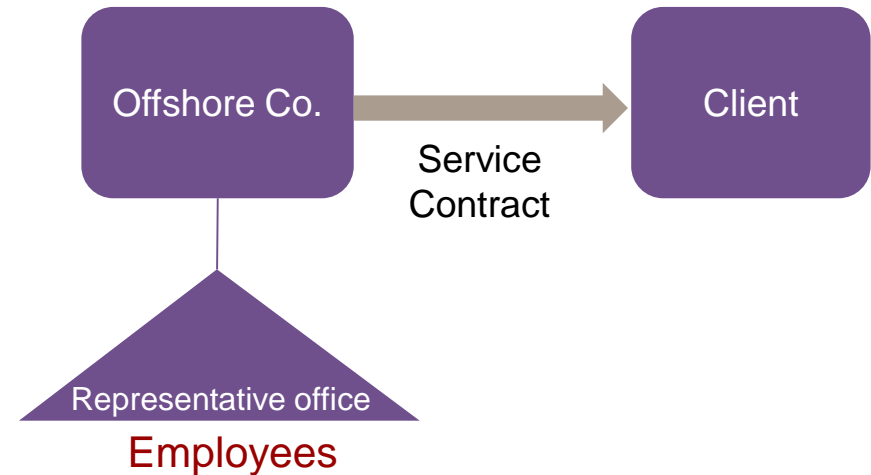
Information above is presented only for the general knowledge reason, it is not legal or professional advice

Making use of offshores: Case #3: Services



Taxation on earnings:

VAT – 12%,
Sales tax– 2%,
Income tax– 10%

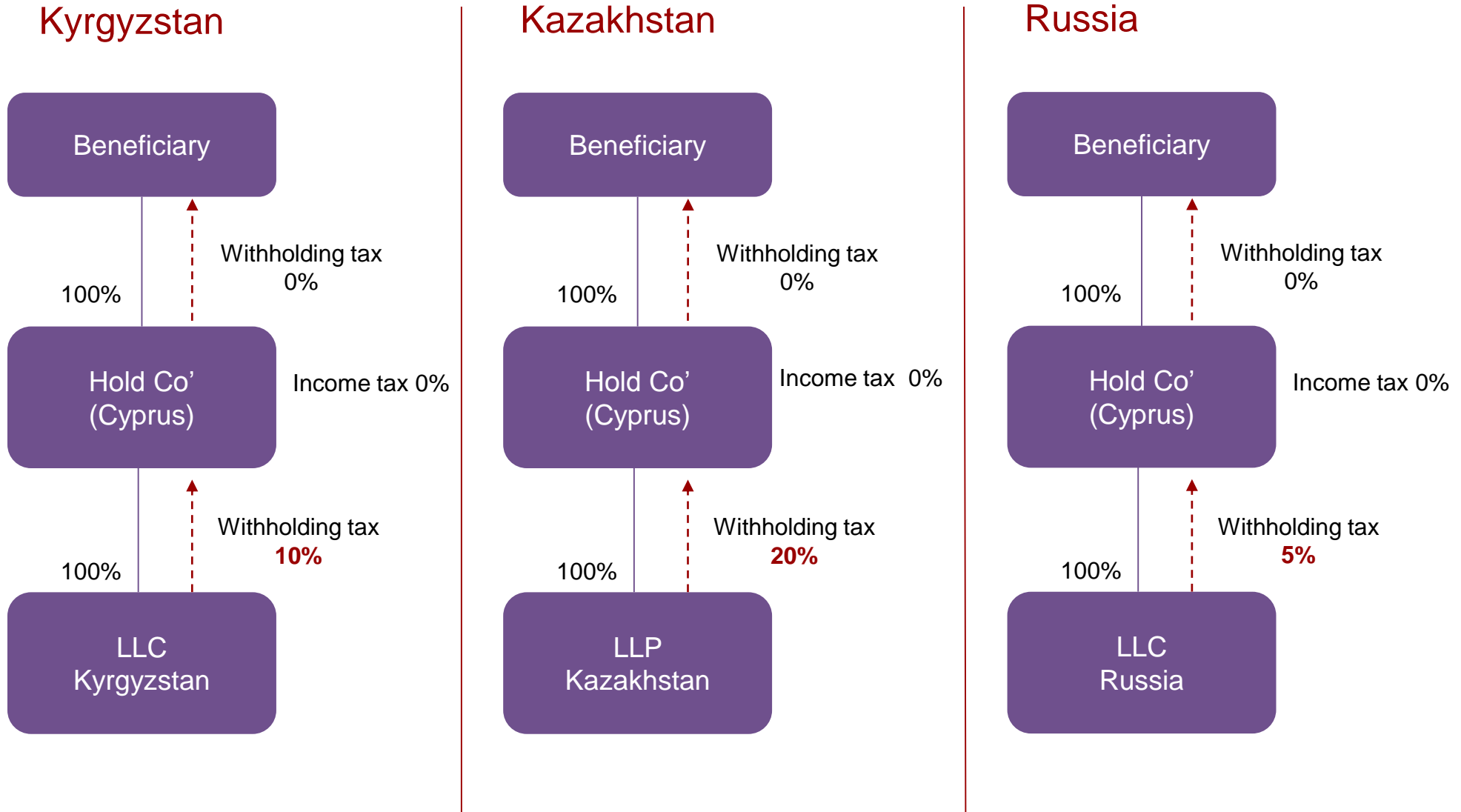


Taxation on earnings:

Income tax– 0% to 10%
Attention to the income tax of the source,
constitution of permanent establishment

Information above is presented only for the general knowledge reason, it is not legal or professional advice

Making use of offshores: Dividends



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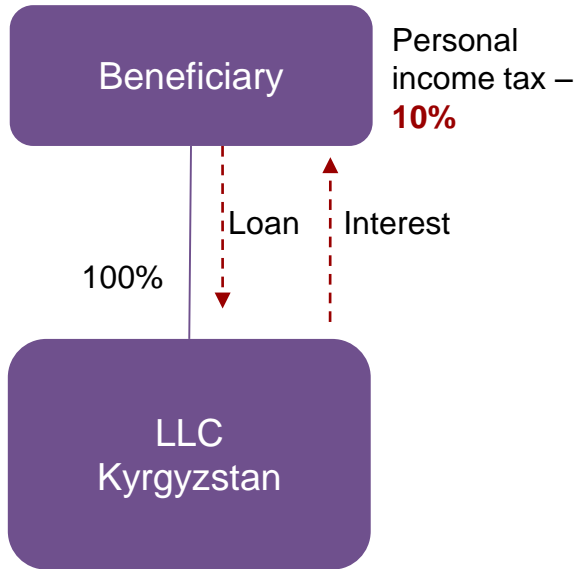
Making use of offshores: Latvia



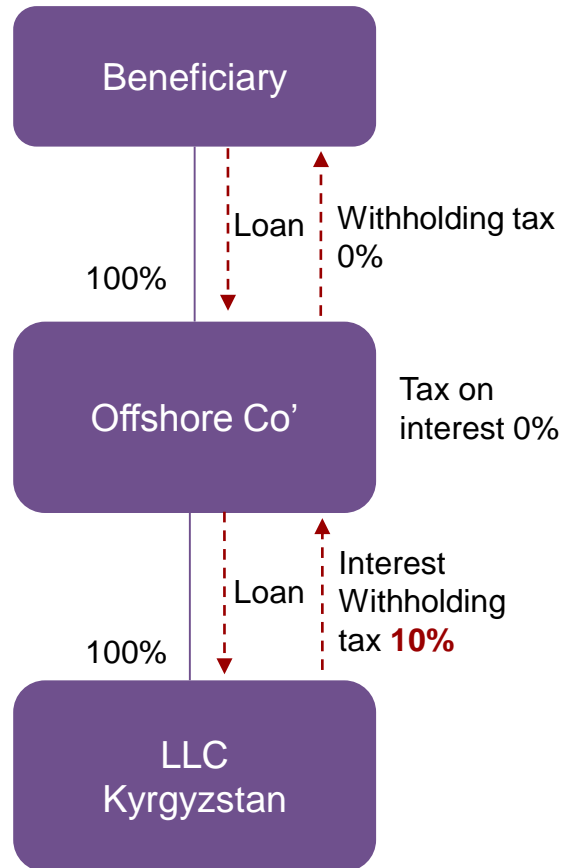
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Making use of offshores: Interest

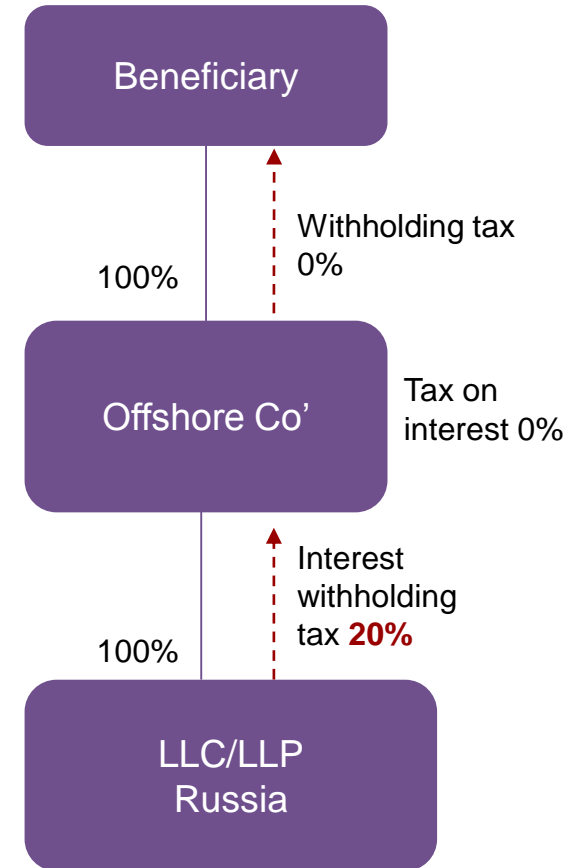
Kyrgyzstan



Kyrgyzstan



Russia/Kazakhstan



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Estimated costs

Countries	Cyprus	Netherlands	Latvia	BVI
Registration	~1.800 EUR Bank account in Cyprus – 200 EUR Bank account in Switzerland– 400 EUR	~5.000 EUR	~1.375 EUR	~1,000-2,000 EUR
Manager, secretary	~1.000 EUR/year	~5.000 EUR	-	From 1,000 EUR and above
Legal address	~350 EUR/year		~1.000 EUR	
Accounting and tax reports, audit	~1.700 EUR/year		~1.800 EUR	
Longevity of opening process	2 weeks	2 weeks	3 weeks	2 weeks

Worldwide tax practice against offshores

Tool #1.

Deals with offshore companies are controlled to avoid transfer pricing.

Kyrgyzstan: Formally “Yes ”(control of deals between mutually dependent companies or foreign trade deals)

Tool #2.

Introduction of thin capitalization rule to limit interest deductions on loans from affiliated companies.

Kyrgyzstan: No

Tool #3.

Introduction of CFC (Controlled Foreign Company) rule. Result: taxation of unallocated dividends.

Kyrgyzstan: No

Tool #4.

Introduction of notion on tax residency for foreign companies according to their actual operations.

Kyrgyzstan: No

Information sources

DTT, Convention of OECD on Mutual Administrative Assistance in Tax Matters (90 countries), FATCA.

Kyrgyzstan: DTT – yes (20 countries)

Why Mazars?



Petros Nacouzi,
Mazars Cyprus, BVI



Michael To
Mazars Hong Kong



Frederik Habers
Mazars Netherlands



Paul Giglio
Mazars Malta

Contact Mazars in
Kyrgyzstan & we will
arrange it for you



David Sayers
Mazars United Kingdom



Oleg Sejans
Mazars Latvia



Pierre Friderich
Mazars Luxembourg



Gassan Sakhnini
Mazars United Arab Emirates

Thank you for attention!

QUESTIONS?

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