

# How The Development of the Financial Accounting System Affects Investment Decision

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## Abstract

The paper investigates the recent development of accounting legislation and standards in Macau. A free market operation must be accomplished by a good accounting system in order to create an attractive investment environment to both foreign and internal investors in Macau. It is more important to provide a fair tax system to the investors in order to generate more tax revenue. Accounting is a relatively new profession in Macau and this paper further highlights its future development after Macau became a Special Administrative Region of the People's Republic of China on 20<sup>th</sup> December, 1999. Finally, the relationships among the current accounting system, Macau economy and society will be discussed. The paper concentrates the discussion on four areas; they are the accounting standard and legislation, the accounting professional, the control system and the taxation system in Macau.

## 1 The Characteristics of the Macau Financial Accounting

Macau accounting system has evolved from the Portuguese standards. The current accounting system was adopted since 1<sup>st</sup> January, 1984. The Macau government, under *Decreto-Lei No. 34/83/M*, designed an accounting system based upon the local economic environment which enables all business sections to follow a uniform accounting system for both internal and external reporting. Under *Decreto-Lei No. 21/78/M*, the taxation law, it is necessary for all companies to prepare standard form of financial statements for the taxation purpose. Hence, the standard format of balance sheet and income statement must be submitted for the tax evaluation. This accounting standard provides minimum guidelines for all sectors and provides important meaningful information for those parties using such data, they are including the tax authority, bankers, investors, debtors, educators, accounting companies and shareholders etc.

However, there are two exemptions when applying the accounting standard. First, sole traders with no more than four persons in the manufacturing company; second, sole traders with fewer than three persons in a commercial or trading company do not need to prepare and follow the standard format of reporting. Although there is a standard format for the preparation of financial statements, the Macau government permits subjective estimation in the computation of operational income and in the valuation of assets. Nevertheless, companies are required to state clearly the reasons for the subjective estimation and the method of valuation. As a result, the accounting legislation and standard provide the following guidelines for the preparation for the financial statements,

- 1.) balance sheet statement,
- 2.) profit and loss statement,
- 3.) balance sheet and profit and loss supplementary statement,
- 4.) uniform accounting categories,
- 5.) uniform accounting categories' code,
- 6.) uniform accounting categories' explanation, and
- 7.) asset valuation methods.

## **2 The Future Development of Accounting System in Macau**

The design of the accounting standard mainly concerns the financial accounting reporting. In addition, accounting is a relative new subject and it is important to improve the current system in order to get in line with the rapid growth of the economy. Macau's GDP in 1998 was about US\$ 13,000 per capita with an annual growth rate in recent years about 4.5%. It is expected the changes of the future accounting system may be affected by the following factors,

### **2.1 Impacts of the Accounting System in the Republic of China**

After the completion of the colonial era, Macau recently formed part of the Republic of China as a Special Administration Region (SAR). The relationship with China becomes more closely in term of economic and political development. It is expected more business and commercial transactions between the two areas will be increased repaidly. To a certain extent, the legislation and the accounting system of the Republic of China may affect the future development of Macau's accounting system.

### **2.2 Improvement of Current Financial Accounting System**

Macau still enjoys considerably autonomy, particularly over economic and social policy. The judiciary is based on the "basic law" drafted by China which envisages a continuation of the present legislation. In other words, the current accounting system should not have any tremendous changes. However, such system is only evolved from the Portuguese in the past sixteen years. Although the Portuguese accounting legislation can apply to the local society, it may require a continue improvement in order to create a more suitable system for the local environment and to stimulate more investments. It is expected the new government of the Special Administration Region (SAR) will work together with the big accounting firms in Macau, the Macau Accounting Society, academic institutes and business sectors to improve the current accounting standard and legislation.

### **2.3 Internal Reporting**

Standard has been provided the guidelines for the financial accounting format only. No standard reports are attempted to set for the internal reporting; such as cost accounting, management accounting and the methods of financial statement analysis etc. As more Macau companies developed their international markets, it is important for them to standardize their internal accounting reports in order to increase their competitiveness in the international markets.

## **3 Accounting Professional and Its Control System**

Recently, the professional qualification can be obtained from a new institute, the Macau Society of Certified Public Accountant (MSCPA) which was formally established in 1994. According to the statistics provided by the MSCPA, there are approximately three hundred certified accountant members and one hundred and sixty student members. The society places the accounting qualification in Macau on a uniform basis. It cooperates with the British Chartered Association of Certified Accounting society (ACCA) to grant the professional qualification in Macau, i.e., the applicants must obtain all papers passed in the ACCA examination with relevant working experience in the accounting professional before they can be qualified. Furthermore, the MSCPA provides lots of training opportunities for the Macau society. It also arranges training courses, examinations and venues for other international accounting societies such as Chartered Institute of Management Accountants from UK and Canadian General Accountants etc. The membership numbers of the MSCPA will be anticipated to increase because its recent rapidly expansion and the local economic growth. The MSCPA is now working together with the government closely to implement the accounting legislation and standard in Macau and to improve the accounting legislation for the new SAR government. In addition, the MSCPA ensures and monitors the quality of services provided by the certified public accountants in Macau. The MSCPA also plays significant role maintain the reputation of the accounting professional in Macau. Finally, another significant role of the accounting society is to protect the

interests for its members. The development of the accounting professionals may be affected by the following factors,

### **3.1 Increase the Communication Between the Accounting Society and the new SAR Government**

The MSCPA works together with the government and is now playing an significant role in the accounting professional including the setting of the accounting legislation, monitoring the accountants' quality, protecting the accountants interests and implementing the accounting standard.

### **3.2 Improvement of the Current Accounting System**

Macau possesses her own taxation, economic and social characteristics. The MSCPA should conduct the accounting training for its members according to the local conditions such as taxation, audit system and accounting standard. An own independent examination should be designed to qualify their members so that the quality of the certified accountants can be improved in Macau. The cooperation between the other international accounting institutes, such as British Chartered Association of Certified Accounting society (ACCA), and MSCPA should be maintained but the certified accountants should possess the knowledge of the local environment e.g. taxation. Hence, the exemption to certify an accountant should not be granted for those without any local knowledge.

### **3.3 Accounting Training**

MSCPA should conduct more training courses for the society in order to produce more high quality and quantity accountants. It should work with other local institutes such as the Macau university, polytechnic college, accounting firms, government and other business sectors for all kinds of accounting training. It is believed that the high standard of accounting reports and its transparency can help to increase better investment for both local and foreigner investors. The international reputation of Macau can also be increase.

## **4 Taxation Characteristics**

Companies are regarded as resident companies when they are operating in Macau, other companies are classified into non-resident companies. Only revenue derived from Macau will be charged for tax. The resident companies are taxed on a worldwide basis. However, any foreign tax paid can be treated as expense and can be deducted from the taxable revenue in order to avoid the double taxation. Thus, Macau does not have any trade agreement with any foreign countries, i.e., there is no exemption for them to pay the foreign taxes.

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All commercial and industrial activities that are conducted in Macau are taxable in accordance with tax rules. The tax rate in Macau is relatively low comparing to other South-east Asia countries and Macau also is adopting a simple tax system. The tax system can be classified into indirect and direct taxes. The direct taxes include an Industrial Tax (*Contribuicao Industrial*), the Complementary Tax (*Imposto Complementar*), a Professional Tax (*Imposto profissional*), an Urban Property Tax (*Contribuicao Predial Urbana*), and a Gift and Inheritance Tax (*Sisa*). The major taxes revenue are delivered from the Professional Tax and the Complementary Tax. An individual can be subjected to both Professional Tax and Complementary Tax. Married couples will be assessed separately for the Professional Tax only. The paper is, therefore, to concentrate the discussion on these two taxes,

### **4.1 The Professional Tax**

“Salary” or “Income” tax has been renamed as the “Professional” tax in Macau. The tax authority requires companies to withhold tax on employees’ net chargeable income tax every month and remit it directly to the tax authority. Thus, employees suffer tax deduction at source. All revenue, whether in monetary form or otherwise, derived directly from work, are subject to tax (*Decreto-Lei no. 2/78/M*). There

are two groups of professional taxpayers. Group 1 and Group 2 respectively. Group 1 refers to those who are being employing by companies in Macau. They pay their professional tax rate on a sliding scale between 10 percent starting at Mop\$ 100,000 and 15 percent on income over Mop \$295,000 in 1998. The calculation of tax revenue is based upon the net chargeable income. Hence, the taxpayers are charged after the deduction of all exemptions which are derived from housing, furniture, electricity, servant, motor vehicle, driver and telephone bill. Table 1 shows the computation of the marginal tax rate of the professional tax.

**Fig 1 The computation of professional tax (Decreto-Lei no. 4/92/M)**

Net Chargeable Income (MOP)	Tax rate (%)
\$100,000	10
115,000	11
145,000	12
205,000	13
295,000	14
295,000 or above	15

\*no tax will be charged with the income less than \$100,000 per annual

In addition, another main characteristics of the professional tax in Macau is that many people are exempted from the tax, they are including:

- i) civil servants of the Macau Public Administration or its services, establishment and organization,
- ii.) servants of collective persons of public administrative utility,
- iii.) personnel of consulates,
- iv.) personnel at the service of foreign or international organizations, in terms of the contracts celebrated by the Portuguese government of the Territory of Macau,
- v.) clergymen of any religion, and
- vi.) casual labours above the age of sixty years and apprentices

The Group 2 taxpayers are those providing professional and technical activities or who are self employed. In this case, the Professional Tax is calculated according to government predetermined fixed rates for different professions. Examples of this group of taxpayers are auditors, civil engineers, chemists and surgeons. If the amount of the professional tax calculated from these fixed rates is less than the amount obtained by using the tax rates shown in table 1, Group 2 taxpayers are required to pay the greater amount.

## 4.2 Complementary Tax

“Profit” tax has been renamed as “complementary tax” The taxpayers of the complementary tax are divided into two categories, Categories A and B respectively. Category A taxpayers consists of persons or companies who are required to have standard accounting system, capital of not less than Mop\$1 million and who have paid profit tax for the last three years averaging Mop \$500,000 or more. The financial statements of this group must be audited by a recognized Macau certified auditor or accountant. Category A taxpayers compute their tax based upon rates beginning at 2 percent on the net chargeable income over Mop \$20,000 and rising to 30 percent on income over Mop \$300,000. All other companies are classified as Category B. Category B taxpayers are required to report their financial situations to the government individually and they are taxed based upon their self-estimated profit. However, the self-estimated taxable profit may be vetted by the Financial Service Department and it should provide sufficient evidences for the such profit evaluations. The tax rate varies by industries and is determined on a case by case basis.

The indirect Taxes include Tourism Tax, Stamp Duties, Consumption Tax, Revenue from Certificate of Origin (a kind of export tax) and other miscellaneous revenues. One of major revenue is derived from the Consumption Tax. It brought about 5% of the government’s total tax revenue in 1998.

Gambling tax brought the largest revenue for Macau, it was about 45% of the total revenue and employed 15% of the total working population. In other words, the gambling industry plays a significant role in the Macau economy.

## **5 The Future Development of the Tax System**

The development of the future tax system may be affected by the following factors,

### **5.1 Simplification and Computerized of the Tax System**

Prior to 1978, there is no tax system in Macau. Firms were not required to report their profits to the government. "Regulation on control of auditing and accounting professional" was officially established. The tax reforms permit the Financial Service Department in charge of the tax matters in Macau. It has been giving considerable efforts to simplify the tax regulations in the last ten years. Continuous efforts are being made to simplify the tax declaration through various methods such as simplified the tax declaration processes and payments. Computerization of entire tax process is another major task for the tax authority in the 21<sup>st</sup> century. At the moment, the authority has installed the Centre of Organization and Information for Taxation successfully. It is expected the Financial Service Department will put continuous efforts to improve the current computer system.

### **5.2 Maintain the Low and Simple Tax Rate System**

Macau tax system can be considered one of the lowest and simplest area in the South-east Asia. The tax principles stimulated investment should be maintained and should be the most important goal of the Macau's government. According to the "Basic Law", the current tax system characteristics will continue in the future.

### **5.3 Increase the Tax Control of the Small Business**

Over 90% of enterprise in Macau can be considered as small business operations from the 1998 census. According to the tax regulation, they can produce self estimation reports on profit return and submit to the tax authority for the tax evaluation. Therefore, the SAR government should increase the control or audit procedures for the small business accounting reports in order to reduce the possibilities of under estimation of the revenue from this sector.

### **5.4 Widen the tax net**

As the aforementioned, professional taxpayers entitle to claim many tax exemptions; such as driver, electricity, telephone bill and servant etc.; before submitting their chargeable income for the tax evaluation. After the deduction of those exemptions, many people can avoid to pay tax. In order to protect the revenue from the direct tax, the new SAR government should consider to reduce such exemptions so that more people can fall into the tax net. In addition, SAR government should consider this imperfect of tax system and makes the appropriate amendments for the tax regulation. Furthermore, the civil servants are now enjoying many privileges which were developed from the previous colonial government such as tax exemption and special bonuses. Under the fairness principle of taxation, these privileges for the civil servant should be terminated. Although Macau is now not relying on the revenue from direct tax, it is very important to develop a better tax system in order to maintain direct tax revenue for the government.

### **5.5 Indirect Tax Revenue**

The major revenue from the indirect tax is obtained from the invisible trade, i.e. tourism and the gambling industry. Macau should not rely too much on the gambling industry for the economy. This industry confronts keen competitions from other neighbour countries and the gambling ships operating near the coast of Macau. The GDP has recorded a negative figure - 4% in 1998. Therefore, Macau should diversify into the financial, high technology, transportation and communication industries in the future.

## **6 Conclusion**

After the above discussion concerning the financial accounting characteristics of Macau and how it may affect the economy, we can summarize that the current accounting and tax system are still considered to be imperfect for the economic and business environment. Studies and analyses are still needed to improve the system periodically. The indirect tax is still very important for the new SAR government, but the government should not rely on the indirect tax revenue too much. The current direct tax system makes people to avoid paying tax, the SAR government should increase the control of the small business accounting reports and reduce exemptions for the professional tax. A good accounting system, fair, simple and low tax system is expected to stimulate more investment in Macau.

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