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Seeding Malaysia's Digital Economy.

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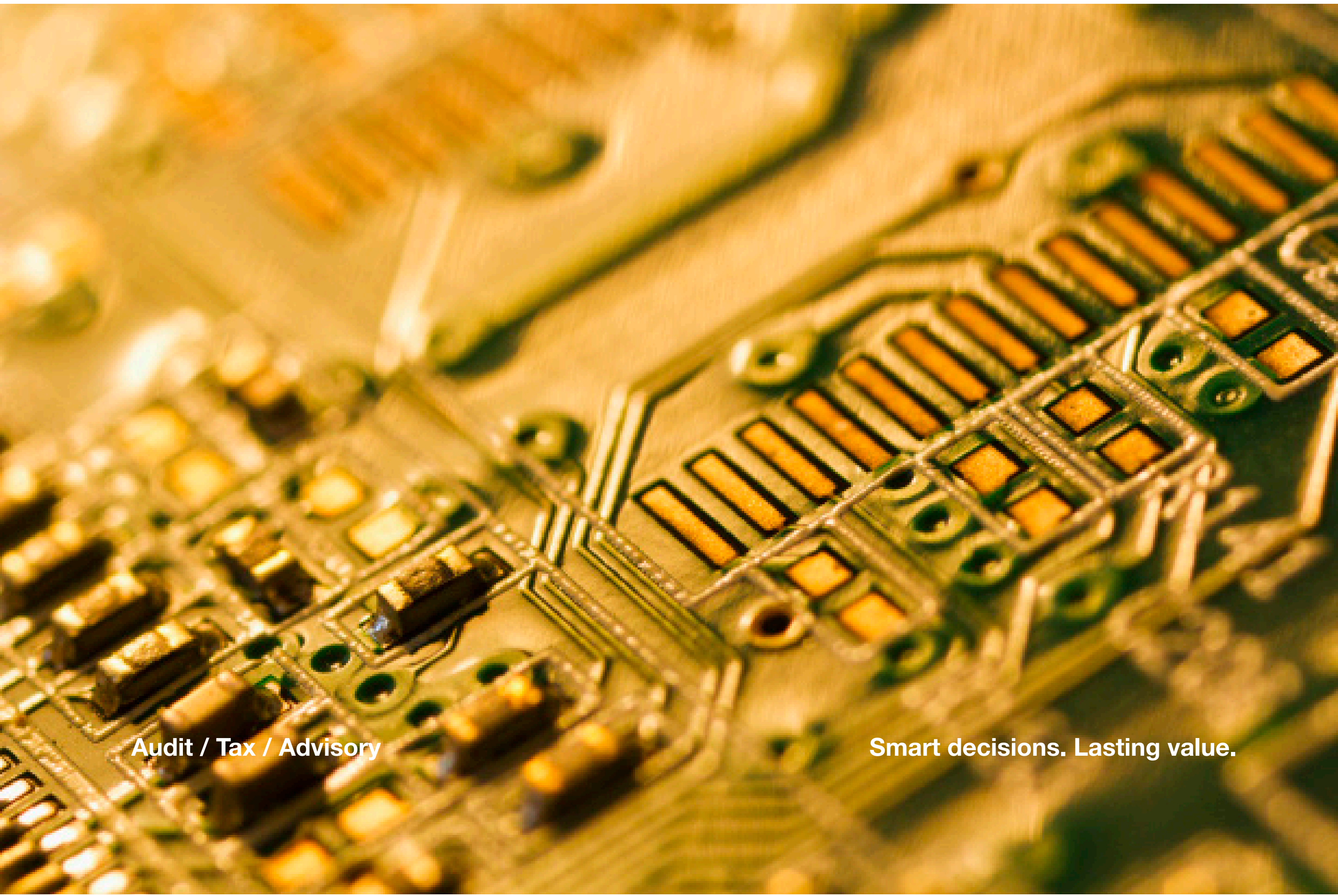

Seeding Malaysia's Digital Economy

After announcing the intention to introduce the first digital free trade zone in the world during the Budget 2017 speech in October last year, Dato' Sri Najib Tun Abdul Razak made it a reality on 22 March 2017 when he launched Malaysia's Digital Free Trade Zone (DFTZ) together with Jack Ma, founder and Executive Chairman of Alibaba Group. The DFTZ is part of Malaysia's National E-Commerce Strategic Roadmap, which aims to double e-commerce growth from 10.8% to 20.8% by 2020.*

The DFTZ will see the creation of a new Kuala Lumpur Internet City (KLIC) in Bandar Malaysia, which aims to attract 1,000 Internet-linked firms and 25,000 tech professionals by taking up 5 million sq ft (464,515sq m) of space within Bandar Malaysia built over 15 years. This is even bigger than the Mid Valley City which has total area of 4.5 million sq ft. Alibaba will be occupying 500,000 sq ft (46,451sq m) to set up small businesses.

* Baker McKenzie, Malaysia Launches Digital Free Trade Zone, 7 April 2017.

As part of its strategic collaboration with the government of Malaysia, Alibaba will be participating in four key areas of the DFTZ. These include:

E-fulfilment hub
Set up within the KLIA Aeropolis on a 8ha piece of land given by the Malaysian government to facilitate the smooth clearance of imports and exports resulting in faster delivery of products to consumers.

E-service platform
The e-service platform in Malaysia will be connected to the Alibaba One Touch Platform, which will link Malaysia to Hangzhou's Cross Border E-Commerce Pilot Zone to enable SMEs of the two nations to trade efficiently.

E-payment and financing
Alibaba has signed pacts with Maybank and CIMB for e-payment and financing to facilitate business-to-business trades.

E-talent development
Leveraging on its cloud, big data and Internet of Things (IoT) technology, Alibaba's e-talent development unit will help local entrepreneurs and startups to train and develop e-talents.

The key beneficiaries of DFTZ include:

- Malaysian consumers who make purchases from e-commerce companies situated within the DFTZ will be exempt from import duty and GST as purchases below RM1,200 will be tax free.
- Malaysia Airports will gain from rental income to be generated from LCCT which has been left vacant since Air Asia’s move to KLIA2.
- Malaysian Inland Revenue with potential tax revenue from e-commerce and other companies operating in KLIC although some tax revenue may be lost in initial years for companies granted pioneer status.
- Logistic companies and freight forwarders.
- Generation Z employees with the DFTZ project expected to create 60,000 new jobs.
- Local SMEs increasing their exports via the DFTZ e-commerce gateway.

In addition to the above benefits, the DFTZ will create an entirely new ecosystem to spur the growth of other digital technology companies in the areas of software development, cloud computing and big data analytics. For example, the millions of customer spending behaviours harvested from e-commerce platforms could be used by big data software companies.

Doing Business in the Digital Economy

The impact of digital innovation has become more obvious in the last few years with e-commerce sales seeing a major boost. Digital technology has changed how we do business but while big corporations have greatly adapted to the changing scenario, small businesses everywhere are finding it difficult to accept and keep pace with the digital economy.

Technology is fast becoming a necessity to all businesses. To be able to compete, SMEs have to become tech-savvy and hire staff who are digitally savvy. Every business from an online clothing store to a software provider to a physical store needs to be tech-savvy. The demand for employees with enhanced digital skills is also rising. With population continuing to age, this could have a huge impact on the employment rate as businesses will begin to do away with older employees and replace them with Generation Z employees born in the digital era with more knowledge on how computers and the digital economy works.

Key points that technology companies should take note include:

- MFRS 15 creates a single source of revenue requirement for all entities in all industries. Although principles-based, like current MFRS, the new revenue standard may result in a significant change and will require technology entities to exercise more judgement than they do currently.
- The new revenue standard applies to revenue recognition on contracts with customers and replaces all of the revenue standards and interpretations in MFRS, including MFRS 111 - Construction Contracts, MFRS 118 - Revenue and other related interpretations. When there are more than two parties to an arrangement, determining whether to present gross or net revenue for the sale of goods or services will continue to be challenging and will require significant judgement.
- MFRS 15 could change practice for technology entities that sell their products through distributors or resellers, potentially accelerating the recognition of revenue.
- Entities will be required to capitalise incremental costs of obtaining a contract (e.g., sales commissions) that meet certain criteria. This will change practice for entities that currently expense such costs.
- The recognition and measurement requirements in MFRS 15 also apply to the sale of certain non-financial assets.
- The standard is effective for annual reporting periods beginning on or after 1 January 2018, with early adoption permitted. All entities will be required to apply the standard retrospectively.

Accounting Standards for Technology Companies

Technology companies may need to change their revenue recognition policies and practices as a result of the adoption of MFRS 15 – Revenue from Contracts with Customers commencing 1 January 2018. MFRS 15 specifies the accounting treatment for all revenue arising from contracts with customers. It affects all entities that enter into contracts to provide goods or services to their customers. The new standard could also change practices of technology companies that sell their products through distributors or resellers.

Under MFRS 118 - Revenue, if the sale price charged to the distributor or reseller is not finalised until the product is sold to the end-customer, entities may wait until the product is sold to the end-customer to recognise revenue. Under the new revenue standard, based on the facts and circumstances of an arrangement, technology entities could reach different conclusions than they do today and recognise revenue earlier because they will be required to estimate variable considerations and include these amounts in the transaction price, subject to a constraint. Applying the constraint on variable considerations introduces a threshold for recognition and measurement that differs from MFRS 118.

MFRS 15 specifies the requirements an entity must apply to measure and recognise revenue and the related disclosures, including cash flows arising from a contract with a customer. The core principle of the standard is that an entity will recognise revenue at an amount that reflects the consideration to which the entity expects to be entitled in exchange for transferring promised goods or services to a customer.

The principles in MFRS 15 are applied using the following five steps:

1. Identify the contract(s) with a customer

2. Identify the performance obligations in the contract(s)

3. Determine the transaction price

4. Allocate the transaction price to the performance obligations

5. Recognise revenue when (or as) the entity satisfies each performance obligation

Technology companies will need to exercise judgement when considering the terms of the contract(s) and all relevant facts and circumstances, including implied contract terms. An entity will also have to apply the requirements of MFRS 15 consistently to contracts with similar characteristics and in similar circumstances. On both an interim and annual basis, an entity will generally need to disclose more information than it does under the current MFRS. Annual disclosures will include qualitative and quantitative information about the entity's contracts with customers, significant judgements made (and changes in those judgements) and contract cost assets.

The model in MFRS 15 applies to each contract with a customer. Contracts may be written, oral or implied by an entity's customary business practices, but must be legally enforceable and meet specified criteria.

Under MFRS 138 - Intangible Assets and IC Interpretation 132 - Intangible Assets: Web Site Costs, a website that is developed for internal or external access is an internally generated intangible asset and must be capitalised if an entity can demonstrate all of the following criteria:

1. Its ability to measure reliably the expenditure attributable to the website under development;
2. The technical feasibility of completing the website so that it will be available for use;
3. Its future economic benefits are probable;
4. Its intention to complete and the ability to use the developed website; and
5. The availability of adequate technical, financial and other resources to complete the development of website.

Capitalisation of Development Expenditures

Many e-commerce companies incur significant costs in relation to developing and maintaining Internet websites to promote or advertise their products or services. Proper accounting for website development costs are becoming a significant issue among small companies and the accounting community has noticed a lack of consistency with respect to its treatment. Some companies consider website development costs as assets, while others treat such costs as expense. These issues become even more challenging for companies that conduct significant e-commerce business and make substantial investments in their websites.

Entities should periodically review existing accounting policies to ensure that they reflect the requirements of accounting standards and interpretations.

If your company operates in the digital economy space or is planning to venture into e-commerce and would like to get advice on accounting standards that may impact your business, please do contact us.

Contact us

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