LEMBAGA PIAWAIAN PERAKAUNAN MALAYSIA
MALAYSIAN ACCOUNTING STANDARDS BOARD

16 October 2007

The Chairman
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Sir David,

IASB EXPOSURE DRAFT OF A PROPOSED IFRS FOR SMALL AND MEDIUM-SIZED ENTITIES

The Malaysian Accounting Standards Board (MASB) appreciates the opportunity to offer its views on Exposure Draft of a Proposed IFRS for Small and Medium-sized Entities, as set out in the accompanying pages.

In general, we believe the draft *IFRS for SME* has provided good basis for financial reporting by entities that do not have public accountability and we congratulate the IASB for the considerable progress made on this SME project.

There are a number of areas we feel are worthy of careful deliberation. Firstly we do not think the title "*IFRS for SMEs*" is a suitable name for the document. The title suggests that the document is for 'small and medium-sized entities' but of which is not. The IASB has indicated that *IFRS for SMEs* is intended and appropriate for an entity that does not have public accountability regardless of the size of the entity, and therefore, we suggest it should be reflected as such. *IFRS for Non-Publicly Accountable Entities or IFRS for Private Entities* or another similar title will be a better description and reflective of the content of the document.

Secondly, we suggest that the public accountability criterion be clearly explained to avoid interpretation of such term. Section 1.2(b), which states that an entity has public accountability if it holds assets in a fiduciary capacity for a broad group of outsiders, is ambiguous and may be interpreted differently unless the IASB defines "fiduciary capacity" and clarifies the parameters of "broad group of outsiders", without which one may only consider the legal form and ignore the substance of the fiduciary capacity. Alternatively, we propose removing section 1.3 to allow national standard setters to determine the scope and applicability of the *IFRS for SMEs* if the IASB does not see it necessary to further clarify "fiduciary capacity" and "broad group of outsiders".

Thirdly, we are concerned about the requirement in section 2.41 which states that after initial recognition an entity generally measures financial assets and financial liabilities at fair value unless the Standard permits other measurement basis. The IASB should clarify when section 2.41 would be applied in practice. This is because

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section 2.32 provides that if the Standard specifically addresses an issue, then the specific provision is followed and for financial assets and financial liabilities, the issue is already specifically dealt with in section 11 of the Standard. This lack of clarification gives the impression that the Standard requires re-measurement of all financial assets and financial liabilities at fair value subsequent to initial recognition.

Fourthly, we do not believe it is appropriate for *IFRS for SMEs* to mandate the use of fair value model in areas such as financial instruments, share-based payments and agriculture on grounds of cost-benefit. If, however, the IASB feels strongly on the use of fair value measurement basis for SMEs, we suggest the use of fair value be restricted to circumstances where quoted price in an active market is available when it is applied to SME.

On agriculture, section 35 of the draft *IFRS for SMEs* only permits the use of cost model in the measurement of biological assets in cases where the fair value is not readily determinable without undue cost or effort. Although this appears to be a 'relaxation' to determining the application of fair value of biological asset, an entity who has applied the cost model is required to disclose the range of estimates within which fair value is highly likely to lie, if possible. To require such disclosure is as good as using the fair valuation method and hence, would defeat the purpose of allowing the cost method.

Finally, we suggest that the expression "undue cost and effort" be further elucidated. It would also be helpful if the Standard explains the connection of "undue cost and effort" to "impracticable" which has been clearly explained in the IFRS. Another example is the term "tax basis" in the draft and "tax base" in IAS 12. We believe the same term should be used in both *IFRS for SMEs* and full IFRS if they were to have similar intended meaning.

The above are general comments we have on the Exposure Draft. Comments on specific issues raised in are set out in the accompanying pages.

If you need further clarification on the response, please feel free to contact Dr Nordin Mohd Zain, the Executive Director at +603 2715 9199 or e-mail at nordin@masb.org.my.

Yours sincerely,

Dato' Zainal Abidin Putih
Chairman

IASB Exposure Draft
IFRS for Small and Medium-sized Entities

Question 1 – Stand-alone document

In deciding on the content of the proposed IFRS for SMEs, the IASB focused on the types of transactions and other events and conditions typically encountered by SMEs with about 50 employees. For such entities, the proposed IFRS is intended to be a stand-alone document, with minimal cross-references to full IFRSs.

With the objective of a stand-alone document in mind, are there additional transactions, other events or conditions that should be covered in the proposed standard to make it more self-contained? Conversely, is there guidance in the draft standard that should be removed because it is unlikely to be relevant to typical SMEs with about 50 employees?

Response

Yes, we believe the draft *IFRS for SMEs* has met the objective of a stand-alone document. Minimal cross-references to full IFRSs for the more complex alternatives are acceptable in the event such transactions occur. Nonetheless, the IASB has to be mindful of the implication of cross-references to full IFRS because the IFRS themselves cross-refer, and hence, may create confusion as to where the cross-referencing will end for the *IFRS for SMEs*.

In addition, we propose the following areas be included in the *IFRS for SMEs* to make it more self-contained as they are not uncommon among SMEs.

a) Business combinations

Business combination achieved in stages

We propose that the IFRS for SMEs to include business combination transactions which may involve more than one exchange transaction; in particular, explain how an entity shall treat each exchange transaction separately using the cost of the transaction and fair value information at the date of the transaction to determine the amount of any goodwill associated with that transaction.

Initial accounting determined provisionally

We propose that the *IFRS for SMEs* to explain, as in IFRS 3 *Business Combinations*, how an entity shall account for a business combination where the cost of the combination can only be determined provisionally upon initial recognition and any adjustments to those provisional values as a result of completing the initial accounting within twelve months of the acquisition date.

b) Leases

We propose that the *IFRS for SMEs* to include leases of land and buildings and clarify how the minimum lease payments shall be allocated between the land and building elements. We reiterate that leases of land and buildings are prevalent among SMEs.

c) Discontinued Operations and Assets Held for Sale

Accounting for impairment

We propose that the *IFRS for SMEs* to include accounting for recognition of impairment losses of a disposal group and the impairment test for a subsidiary held for sale.

Unless it is the intention of the IASB, users may disregard the need for impairment assessment for this group of assets in the absence of any specific requirement.

Scope

IFRS 5 *Non-current Assets Held for Sale and Discontinued Operation* paragraph 5 specifically scopes out assets covered in IAS 12 *Income Taxes*, IAS 19 *Employee Benefits*, IAS 39 *Financial Instruments: Recognition and Measurement*, IAS 40 *Investment Property* (limited to assets carried at fair value), IAS 41 *Agriculture* and IFRS 4 *Insurance Contracts*.

However, section 36 *Discontinued Operation and Assets Held for Sale* of the draft *IFRS for SMEs* does not contain such provision. This gives the impression that there is no similar exclusion as in IFRS 5 unless the draft *IFRS for SMEs* explicitly specifies such exclusion.

We propose that the *IFRS for SMEs* be clear in its scope on section 36.

d) Potential Voting Rights

Section 9.9 of the draft *IFRS for SMEs* explains how an entity shall prepare consolidated financial statements when potential voting rights exist.

However, unlike IAS 27, there is no similar explanation on whether potential voting rights should be considered when assessing whether control exist. Hence, this gives the impression that potential voting rights need not be considered in determining control.

We believe it will provide more clarity to *IFRS for SMEs* if similar explanation is included.

e) Original Issue of Shares or Other Equity Instruments

Section 21.3 of the draft *IFRS for SMEs* explains that an entity shall measure equity instruments at the fair value of the cash or other resources received or receivable, net of direct costs of issuing the equity instruments.

The same principle, however, is not provided in full IFRSs, which is the more complete set of standards.

Whilst it may be good to provide additional guidance, the IASB should take cognizance of the IASB's ongoing project on liabilities and equity since the *IFRS for SMEs* is developed based on the fundamental concepts from the IASB's Framework and the principles in IFRSs though modifications may be made in light of users' needs and cost-benefit considerations.

Question 2 – Recognition and measurement simplifications that the Board adopted

The draft *IFRS for SMEs* was developed by:

(a) extracting the fundamental concepts from the IASB *Framework* and the principles and related mandatory guidance from full IFRSs (including Interpretations), and

(b) considering the modifications that are appropriate in the light of users' needs and cost-benefit considerations.

Paragraphs BC70–BC93 of the Basis for Conclusions describe the simplifications of recognition and measurement principles contained in full IFRSs that have been made in the proposed IFRS for SMEs and explain the Board's reasoning.

Are there other recognition or measurement simplifications that the Board should consider? In responding, please indicate:

(a) the specific transactions, other events or conditions that create a specific recognition or measurement problem for SMEs under IFRSs;

(b) why it is a problem; and

(c) how that problem might be solved.

Response

Generally, we believe the recognition and measurement simplifications proposed in the draft *IFRS for SMEs* are satisfactory except:

(a) Fair value measurement basis

We believe the *IFRS for SMEs* should prescribe the use of fair value measurement basis only in circumstances where market prices are readily available.

This is especially crucial for SMEs operating in less developed capital market which will often lack access to observable market data necessary to determine fair values. For example, it could be difficult for SME to determine the fair value of the equity instrument granted under the share-based payment transaction given the fact that there is often lack of readily market for the transaction. In such case, we suggest the *IFRS for SMEs* should prescribe the use of intrinsic value rather than having the need to justify that the entity is unable to estimate reliably the fair value.

(b) Impairment of non-financial assets.

We suggest the concept of "value in use" be retained.

The draft *IFRS for SMEs* proposes that impairment be assessed by estimating the fair value less costs to sell of the asset. The concept of "value in use" as used in IAS 36 *Impairment of Assets* appears no longer applicable in the draft *IFRS for SMEs*. In IAS 36 impairment occurred when the carrying amount of an asset (or a CGU unit) exceeds its recoverable amount and the latter is the higher of its fair value less costs to sell and its value in use.

By eliminating the concept of "value in use" we believe that the impairment would not be reflective of the business reality. It is not uncommon for entities to buy assets at above fair value because it is anticipated that the cash flow the entity will be able to generate from the asset will exceed the fair value. For example, when an entity buys a line of production plant, the entity could envisage a situation whereby the production plant or the cash generating unit that includes the production plant will be able to generate cash flow that is in excess of their cost. Therefore, to require the entity to impair the production plant to its fair value would not be reflective of the economic business reality.

<u>Other simplifications not proposed in the draft *IFRS for SMEs* for IASB consideration</u>

We believe further simplifications should be provided for the following:

a) Retrospective application

The draft *IFRS for SMEs* proposes that when entities change its accounting policy, the new accounting policy is applied retrospectively as far back as is practicable unless it is impracticable to determine the individual period effects in which the entity shall adjust the opening balance of each affected component.

We suggest the requirement be further simplified to allow retrospective adjustment be adjusted against the opening balance of each affected component without the need to further identify the individual prior periods affected by the change in accounting policy. Adjustments against opening balance are not unusual as this has been applied in full IFRSs before.

b) Documentation of hedge accounting

The draft *IFRS for SMEs* requires an entity to designate and document the hedging relationship in order to qualify for hedge accounting.

We propose that document requirement for hedge accounting be removed. We believe many SMEs worldwide use hedge accounting but will not meet the proposed documentation requirement due to lack of expertise and experience in this area and consequently will not qualify for hedge accounting.

are not unusual throughout the draft *IFRS for SMEs* eg investment property, property, plant and equipment and intangible assets.

In addition, we propose that the IASB removes the disclosure requirement of section 35.1(b)(iii) on the range of estimates within which the fair value is highly likely to lie when the cost method is applied. To require such disclosure is as good as using the fair valuation method and defeats the purpose of allowing the cost method for the agriculture industry.

We disagree with paragraph BC103 *Cost Model for Agriculture*. In fact we believe the cost method is the simpler and preferred option among SMEs whose biological assets do not have active markets, particularly bearer biological assets such as oil palm trees. To require SMEs to fair value biological assets based on a valuation technique will be too onerous as it will involve a lot of subjective and unverifiable assumptions.

Question 4 – Whether all accounting policy options in full IFRSs should be available to SMEs

The draft *IFRS for SMEs* proposes that accounting policy options available under full IFRS should generally also be available to SMEs. As explained more fully in paragraphs BC108-BC115 of the Basis for Conclusions, the Board concluded that prohibiting SMEs from using an accounting policy option that is available to entities using full IFRSs could hinder comparability between SMEs and entities following full IFRSs. At the same time, the Board recognised that most SMEs are likely to prefer the simpler option in the proposed *IFRS for SMEs*. Therefore, the Board concluded that in six circumstances in which full IFRSs allow accounting policy options, the *IFRS for SMEs* should include only the simpler option, and the other (more complex) option(s) should be available to SMEs by cross-reference to the full IFRSs.

Do you agree with the Board's conclusions on which options are the most appropriate for SMEs? If not, which one(s) would you change, and why?

Should any of these options that would be available to SMEs by cross-reference to the full IFRSs be eliminated from the draft *IFRS for SMEs* and, if so, why?

Response

Yes, we agree with the Board's conclusion on the six circumstances in which the simpler option is included in the draft *IFRS for SMEs* and the more complex options are made available to SMEs by cross references to full IFRSs.

However, we would like to seek clarification on paragraph BC108 where the IASB Board concluded that prohibiting SMEs from using an accounting policy option that is available to entities using full IFRSs could hinder comparability between SMEs and entities applying full IFRSs. Is there a necessity to compare entities applying the SMEs standards and those that apply full IFRSs? In any event, we believe the financial statements prepared using the *IFRS for SMEs* will not be comparable to financial statements of entities applying full IFRSs as a result of the simplifications in *IFRS for SMEs.*

Question 5 – Borrowing costs

IAS 23 *Borrowing Costs* currently allows entities to choose either the expense model or the capitalisation model to account for all of their borrowing costs. In May 2006 the IASB published an Exposure Draft proposing to amend IAS 23 to prohibit the expense model and to require the capitalisation model. Section 24 *Borrowing Costs* of the draft *IFRS for SMEs* proposes to allow SMEs to choose either the expense model or the capitalisation model.

Do you agree or disagree with the proposal to allow SMEs to choose either the expense model or the capitalisation model for borrowing costs, and why?

Response

Yes, we agree with the proposal to allow SMEs to choose either the expense model or the capitalisation model for borrowing costs.

Question 6 – Topics not addressed in the proposed *IFRS for SMEs*

Some topics addressed in full IFRSs are omitted from the draft *IFRS for SMEs* because the Board believes that typical SMEs are not likely to encounter such transactions or conditions. These are discussed in paragraphs BC57–BC65 of the Basis for Conclusions. By a cross-reference, the draft standard requires SMEs that have such transactions to follow the relevant full IFRS.

Should any additional topics be omitted from the *IFRS for SMEs* and replaced by a cross-reference? If so, which ones and why?

Response

No, no other topics should be omitted from the IFRS for SMEs.

Question 7 – General referral to full IFRSs

As noted in Question 1, the *IFRS for SMEs* is intended to be a stand-alone document for typical SMEs. It contains cross-references to particular full IFRSs in specific circumstances, including the accounting policy options referred to in Question 4 and the omitted topics referred to in Question 6. For other transactions, events or conditions not specifically addressed in the *IFRS for SMEs*, paragraphs 10.2–10.4 propose requirements for how the management of SMEs should decide on the appropriate accounting. Under those paragraphs, it is not mandatory for SMEs to look to full IFRSs for guidance.

Are the requirements in paragraphs 10.2–10.4, coupled with the explicit cross-references to particular IFRSs in specific circumstances, appropriate? Why or why not?

Response

Yes, we are of the view that the requirements in sections 10.2-10.4 of the draft *IFRS for SMEs* coupled with the explicit cross references to particular IFRSs in specific circumstances are appropriate. Nonetheless, as stated in our response to Question 1, the IASB has to be mindful of the implication of cross-references to full IFRS because the IFRS themselves cross-refer, and hence, may create confusion as to where the cross-referencing will end for the *IFRS for SMEs*.

We are also of the view that the requirements to look to full IFRSs in situations where the draft *IFRS for SMEs* does not address a transaction, event or condition should not be made mandatory. Mandating a reversion to a full IFRS may put the SME in the same class as a publicly accountable entity, thus defeating the original purpose of the *IFRS for SMEs* as the SMEs financial statements are meant to be simplified and also cost less to prepare. We believe management should be given the liberty to select accounting policy that best reflects the economic substance of the transaction.

Question 8 – Adequacy of guidance

The draft *IFRS for SMEs* is accompanied by some implementation guidance, most notably a complete set of illustrative financial statements and a disclosure checklist. A sizeable amount of guidance that is in full IFRSs is not included. Accordingly, additional guidance especially tailored to the needs of SMEs applying the proposed IFRS may be required.

Are there specific areas for which SMEs are likely to need additional guidance? What are they, and why?

Response

We propose that additional implementation guidance to be included for the measurement of the following more complex transactions and to make the *IFRS for SMEs* a more self-contained document:

- ✓ Deferred taxes
- ✓ Consolidation procedures
- ✓ Defined benefit plan
- ✓ Impairment of non-financial assets
- ✓ Intangible assets
- ✓ Financial instruments
- ✓ Agriculture
- ✓ Share-based payments