LEMBAGA PIAWAIAN PERAKAUNAN MALAYSIA
MALAYSIAN ACCOUNTING STANDARDS BOARD

Request for Views on
Private Entities, the Way Forward

Comments to be received by 29 June 2012

This *Request for Views* is issued by the Malaysian Accounting Standards Board (MASB). The MASB will use the information gathered from this document as inputs to the deliberation of developing the financial reporting framework for private entities.

Comments should be submitted in writing so as to be received by **29 June 2012**. All replies will be placed on public record unless confidentiality is requested by the commentator.

Comments should be addressed to:

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Introduction

1 The Malaysian Accounting Standards Board (the Board) introduced the two-tier financial reporting framework in 2006 with the aim to reduce financial reporting compliance burden of private entities.[1] Under the two-tier system, Private Entity Reporting Standards (PERS) was created for private entities. Nevertheless private entities have the option to apply the Malaysian Financial Reporting Standards (MFRSs or MFRS Framework) which is mandatory for entities other than private entities, if they deemed the MFRS Framework to be more appropriate for them.

2 Since the introduction of this two-tier system, the Board had issued the following three exposure drafts[2]:

- Exposure Draft 52 *Private Entity Reporting Standards* (issued in June 2006)
- Exposure Draft 72 *Financial Reporting Standards for Small and Medium-sized Entities* (issued in March 2010)
- Exposure Draft 74 *Amendments to Financial Reporting Standards arising from Reduced Disclosure Requirements* (issued in December 2010)

3 After considering the responses received on the three exposure drafts, the Board published this *Request for Views* to further seek views from interested parties about the future financial reporting framework for private entities in Malaysia.

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[1] A private entity is a private company (as defined in Section 15(1) of Companies Act 1965), incorporated under the Companies Act 1965, that -

- is not itself required to prepare or lodge any financial statements under any law administered by the Securities Commission or the Bank Negara Malaysia; and
- is not a subsidiary or associate of, or jointly controlled by, an entity which is required to prepare or lodge any financial statements under any law administered by the Securities Commission or the Bank Negara Malaysia.

[2] See Appendix 1 on "History of the Two-tier Financial Reporting Framework" for more information on these pronouncements.

4 During the various outreach activities held to gather feedback on these exposure drafts, many constituents, including international parties, have expressed increasing concern that the PERS Framework comprises an outdated set of standards. Given that the framework was developed based on 2003-version of International Accounting Standards, it is without doubt the requirements have not kept pace with the changing business transactions. It also lacks consistent principles with the MFRS Framework in various areas as a result of the developments in financial reporting in recent years. These are important issues that need to be considered as it is universally recognised that a vibrant economy and increased prosperity is dependent on the existence of a thriving community of Small and Medium-sized Entities (SMEs). SMEs in Malaysia account for 99%[3] of the total establishments in the three key economic sectors, namely manufacturing, services and agriculture. Therefore it is important that the local SMEs are able to compete in the regional and global arena. This requires companies' efforts in attracting foreign investments and enhancing their access to financing. Hence, adopting a set of high quality accounting standards would improve companies' transparency and increase both investors' and bankers' confidence.

5 Moreover, the implementation of a two-tier framework had unintentionally created a knowledge gap among preparers as well as auditors. Although private entities have a choice to either apply the MFRS or PERS Framework, it is worth noting that most of the estimated 328,000[4] private companies that are required to have their financial statements audited will usually opt for the PERS Framework as it is a simpler set of standards. While preparers and auditors are formally educated under the MFRS Framework, the knowledge gap arises because most preparers and auditors that are involved in the preparation and audit respectively of private entities financial statements may not have the opportunity to apply the MFRS Framework given most of their time will be spent on applying the PERS Framework.

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[3] Source: www.smeinfo.com.my

[4] Source: Report on the Observance of Standards and Codes (ROSC) Malaysia, February 2012 (www.worldbank.org/my)

6 In addition the Board is cognisant of the Tenth Malaysian Plan target for a 50 percent skilled workforce by 2020[5] in line with the nation's Economic Transformation Programme 2010 (ETP) for Malaysia to become a high-income nation by 2020. The ETP study noted that the private sector's investments have seen decelerated growth in the past years and one of the reasons was due to investors' apprehensions about the availability of skilled professionals. In view of this, the knowledge gap created by the 2-tier system needs to be addressed.

7 However the Board has yet to confirm which one of the three exposure drafts should replace the PERS Framework because a continuous series of events had unfolded within a short period of time that need to be taken into consideration by the Board before finalising its decision.

ED 52 and ED 72

8 ED 52 and ED 72 were issued with the intention of choosing one of them to replace the PERS Framework. From the results of a survey conducted by the Board in 2010 as to which set of standards is more appropriate for the private entities, ED 52 received lesser support when compared to ED 72. The Board noted the reason behind the outcome of the survey could be due to concerns that applying a locally developed set of standards may give rise to perception issue from a global perspective as some may consider national accounting standards to be less robust than ED 72 which is word-for-word the *International Financial Reporting Standard for Small and Medium-sized Entities* (*IFRS for SMEs*).

9 As to ED 72, the Board understands the International Accounting Standards Board (IASB) plans to review the *IFRS for SMEs* soon. The IASB's review is to identify any implementation issues and thereafter an exposure draft addressing the issues may be issued. Hence with the knowledge that there will be a review on the *IFRS for SMEs* soon, the Board has not proceeded to finalise ED 72 for adoption as entities may need to change its accounting policy twice within a short period of time when the IASB issues a revised *IFRS for SMEs*.

[5] Source: Economic Transformation Programme (Chapter 14: Transforming Education as an Engine of Growth)

ED 74

10 At the same time in 2010, the Board observed that Australia issued a Reduced Disclosure Requirements Framework (RDR) that allows non-publicly accountable reporting entities to prepare less complex financial statements by providing them certain disclosure exemptions. The Board considered and noted the merits of Australia's RDR and proceeded to issue ED 74 in December 2010 with the intention of reducing the reporting burden of certain entities that do not have public accountability but have been mandated to apply the MFRS Framework.

11 During the outreach of ED 74, some respondents encouraged the Board to consider adopting ED 74, instead of ED 72, to replace the PERS Framework. The respondents believed that by adopting RDR, the costs (such as training costs, migration costs to the MFRS Framework) of maintaining two sets of accounting standards will be reduced. In addition, the RDR will increase comparability of financial statements as its measurement and recognition criteria are identical to the MFRS Framework. Consequently the RDR will better facilitate consolidation with MFRS reporting entities as some recognition and measurement requirements of the *IFRS for SMEs* are different from the MFRS Framework. The IASB has not indicated if any amendments will be made in its next version of *IFRS for SMEs* to address these differences.

12 The Board has not proceeded to finalise ED 74 in view that the disclosure aspects of RDR which is based on *IFRS for SMEs* may be subject to review by IASB (similar to the Board's rationale for not adopting ED 72). Also, there were concerns that the RDR could impede the usefulness of financial reports as a result of lesser disclosures provided.

13 In addition, ED 74 was developed based on the Financial Reporting Standards (FRSs or FRS Framework) that was replaced by the MFRS Framework with effect from 1 January 2012. Should the Board ultimately decide to replace the PERS Framework with RDR, a revised RDR will have to be developed based on the MFRS Framework. Therefore the Board recognises that consideration should be given to the implementation requirements and how long a period private entities will need to transition to a revised RDR developed based on MFRSs.

Malaysia's XBRL initiative

14 The Board then further noted that there is a reasonable expectation that Suruhanjaya Syarikat Malaysia (SSM) will implement XBRL *(eXtensible Business Reporting Language)* in the near future. According to SSM's XBRL implementation plan which commenced in 2010, they will be developing a 2-tier taxonomy, one of which is based on PERS, and the first phase (operationalisation) is expected to be completed in 2013, with lodgement of financial statements in XBRL format on voluntary basis and will eventually be mandatory[6]. In this regard, the Board recognises the timing of replacing the PERS Framework is critical and that it is imperative its decision on financial reporting for private entities complement and support SSM's initiative.

The Board's 5-year plan

15 In light of these developments, the Board needs to reconsider its initial plan as proposed in the three exposure drafts. While the Board recognises that the PERS Framework is an outdated one which needs improvement quite urgently, the Board is cognisant of initiatives undertaken by the regulatory authorities and that it should strive to find a balanced outcome that would meet the needs of stakeholders and best serve the interest of the country.

16 The Board therefore is considering the possibility of replacing the PERS Framework with a new set of standards only in 2015 with effective date of 2016 to be in line with SSM's XBRL initiative. In the interim, as a practical expedient, the Board will consider reviewing the PERS Framework if there are areas that need immediate improvement or amendment so as to mitigate the increasing concerns about the gap differences between MFRS and PERS reporting.

[6] Source: SSM 2011 National Conference – Gearing Towards Embracing Changes under the New Companies Bill by Nor Azimah Abdul Aziz, Director of Corporate Development & Policy Division Suruhanjaya Syarikat Malaysia (13 June 2011).

Request for Views

17 The *Request for Views* first asks respondents for background information that provides a context in which to understand their views. Additional questions then follow, focused on four broad issues:

- whether the plan being considered by the Board in paragraph 16 is in the best interest of financial reporting for private entities;
- whether there are any immediate changes that the PERS Framework require if private entities continue to apply it until 2015;
- which set of accounting standards would be suitable for private entities post-2015; and
- the expected time and effort involved in properly transitioning to the new financial reporting requirements.

Comments are most helpful if they:

(a) contain a clear rationale, and

(b) if applicable, include an alternative the Board should consider.

The Board will consider all comments received in writing by ***29 June 2012***. In considering the comments, the Board will base its conclusions on the merits of the arguments for and against each alternative, not on the number of responses supporting each alternative.

Question 1 — Background information

Please provide the following information:

(a) Please state whether you are a:

- Preparer of financial statements
- Auditor
- Investor
- Creditor
- If others (for example, regulator, academia etc), please indicate

(b) For preparers of financial statements, please state the following:

- Primary business activity or activities
- Size of organisation — Turnover of
  - Less than RM1 million
  - RM1 million – RM10 million
  - RM10.1 million – RM25 million
  - More than RM25 million

(c) For auditors, please state the following:

- Size of your firm in terms of:
  - Number of audit partners
  - Number of audit employees
- Does your practice focus mainly on private entities or entities other than private entities or both?
- The number of clients that are private entities:
  - Less than 100 clients
  - 101 – 200 clients
  - 201 – 300 clients
  - More than 300 clients

(d) Please explain the degree to which the Board's proposals are likely to affect you and the factors driving that effect.

Question 2 — Future reporting framework for private entities (paragraphs 2-14)

The Board recognises that the PERS Framework is outdated and a change is imminent.

However the Board is considering whether to only implement the new framework in 2016 in view of the many changes that are currently taking place in the environment at the same time. The proposed date takes into consideration IASB's possible issuance timeline of the revised *IFRS for SMEs* and the projected time private entities require to transition to the new framework:

(a) Do you agree with the Board's plan that the implementation of a new framework for private entities should only take place in 2016? If not, why not?

(b) Do you believe the proposal provides sufficient time for private entities to learn about the proposal, train personnel, plan for, and implement or otherwise adopt the new framework? What other factors should the Board consider in deciding the effective date of the new framework?

(c) Which of the following do you believe is the most appropriate and suitable replacement for the PERS Framework? Please state your reasons for and against adopting any of these proposed standards.

    (i) ED 52 *Private Entity Reporting Standards*

    (ii) ED 72 *Financial Reporting Standards for Small and Medium Sized Entities*

    (iii) the upcoming revised *IFRS for SMEs* that the IASB plans to expose in the near future

    (iv) ED 74 *Amendments to Financial Reporting Standards arising from Reduced Disclosure Requirements*

(d) If you believe either ED 72 or the revised *IFRS for SMEs* is suitable, do you believe that modifications should be made to align the recognition and measurement principles to that of the MFRS Framework when deemed necessary? Please state your rationale for your respond.

Question 3 — Short to medium term reporting framework for private entities (paragraph 13)

In the interim, the Board proposes to require private entities to continue applying the PERS Framework up to 2015 or until a new accounting framework is issued.

The Board seeks to understand from stakeholders, if there are any changes or improvements to the PERS Framework that require immediate attention. If yes, please state:

(a) which topic or subject matter in the PERS Framework that requires change?

(b) the rationale and reasons for the change;

Question 4 — Other comments

Please state any other comments or issues you have which have not been addressed in this *Request for Views*.

Appendix 1: History of the Two-tier Financial Reporting Framework

1 This appendix provides a summary of the history of the Private Entity Reporting Standards (PERS) Framework and the exposure drafts issued that may be used to replace the PERS Framework.

Private Entity Reporting Standards (PERS)

2 In 2006, in view of the increasing complexities in IFRS, the Board announced its decision to change the financial reporting framework from a single-tier to a two-tier financial reporting framework with the aim of reducing financial reporting burden of smaller entities. As a result, private entities were given the option to apply either the Malaysian Financial Reporting Standards (MFRS) or PERS Framework.

3 During that period, the PERS Framework is intended to be temporary while the Board develops a set of new standards for private entities. Therefore, the framework introduced in 2006 comprises selected MASB standards (i.e. the Private Entity Reporting Standards) that are appropriate and relevant to private entities. This set of MASB standards are essentially standards issued by the International Accounting Standards Board (IASB) prior to its Improvement Projects in 2003.

4 While waiting for the IASB to issue a separate set of standards for Small and Medium-sized Entities (SMEs), the Board decided to develop its own set of standards and therefore, Exposure Draft (ED) 52 *Private Entity Reporting Standards* was issued in June 2006. ED 52 proposes a comprehensive set of accounting standards for private entities and prescribes the cost bases as the measurement principle for the assets and liabilities of private entities. It also removes certain disclosure requirements which the Board believed are onerous for private entities to comply.

5 The majority of the responses to ED 52 showed a clear demand for separate reporting standards for private entities.

6 When the Board intended to finalise ED 52, the IASB issued an exposure draft on *International Financial Reporting Standards* (*IFRS*

for SMEs) in 2007. In view of the development that was taking place in the IASB, the Board then decided to defer the finalisation of ED 52 while gauging the suitability of IASB's *IFRS for SMEs*.

Exposure Draft 72 Financial Reporting Standards for Small and Medium Sized Entities (FRS for SMEs)

7 In July 2009, the IASB issued the *IFRS for SMEs*. Following that, the Board issued ED 72 in March 2010, which is word-for-word the *IFRS for SMEs*.

8 During the six months comment period of ED 72, the Board jointly with the Malaysian Institute of Accountants conducted seven road-shows and also a survey to seek views from the local constituents about which set of accounting framework for private entities would be in the best interest of Malaysia:

- To continue with the existing PERS;
- To finalise ED 52 *PERS*; or
- To adopt ED 72 *FRS for SMEs*

The survey results indicated that ED 72 was the preferred framework though many supported PERS while ED 52 received the least support.

Exposure Draft 74 Amendments to Financial Reporting Standards arising from Reduced Disclosure Requirements

9 In December 2010, the Board issued ED 74 as a response to address the concerns that certain non-private entities may not have public accountability (e.g. subsidiaries of public listed companies) and hence should not be subjected to the same reporting requirements as the rest of the non-private entities. The Board received suggestions that a *Reduced Disclosure Requirements Framework* may be another suitable alternative for private entities instead of the *IFRS for SMEs*.

10 ED 74 proposes to allow entities that meet the specified criteria to provide lesser disclosures than those required under the Financial Reporting Standards (FRSs or FRS Framework) whilst the recognition and measurement requirements are identical to the FRS Framework. The ED was intended for non-publicly accountable

subsidiaries, associates or jointly-controlled entities whose parent, investor or venturer respectively that is not a private entity.

11 Generally, respondents to the exposure draft showed support for this proposed framework as under this proposed framework, the consistency in the recognition and measurement principles will be maintained. However, there were views that with the reduced disclosures, it may result in insufficient information for the users of financial statements and thus affect the usefulness of the reports for decision making.

Appendix 2: Comparison of differences between *IFRS for SMEs* and MFRSs

This table contains some examples of recognition and measurement principles in the *International Financial Reporting Standards for Small and Medium-sized Entities* (*IFRS for SMEs*) (issued by IASB in July 2009) that are different from the Malaysian Financial Reporting Standards (MFRSs).

Subject matter	*IFRS for SMEs* (=ED 72)	MFRSs (=IFRSs)
Intangible assets	Development cost to be expensed when incurred.	Development cost to be recognised as an asset, if the specified recognition criteria are met
Property, plant and equipment (PPE)	Revaluation of PPE is not permitted.	Revaluation of PPE is allowed.
Investment property (IP)	IP to be measured at fair value through profit or loss if without undue cost or effort.	IP to be measured at cost or fair value.
Borrowing costs	All borrowing costs to be expensed.	Permits capitalisation of borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of the asset.
Income tax	Tax basis is the consequence of the sale of an asset or settlement of a liability. [based on IASB Exposure Draft on *Income Tax* issued in 2009]	Tax base is dependent on the expected manner of recovery of an asset or settlement of a liability.