

**LEMBAGA PIAWAIAN PERAKAUNAN MALAYSIA
MALAYSIAN ACCOUNTING STANDARDS BOARD**

**Roadmap for Private Entities Financial
Reporting Framework**

This Roadmap is issued by the Malaysian Accounting Standards Board (MASB) to provide an outline of the new financial reporting framework for private entities. This Roadmap has also included suggestions on what stakeholders may do during the transition period.

The MASB invites comments on the questions raised set out in the Roadmap by **6 May 2013**. All replies would be placed on the public record unless confidentiality is requested by the commentator.

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Objective

- 1 The objective of this Roadmap is to set out the applicable financial reporting framework, MASB ED 72 *Financial Reporting Standards for Small and Medium-sized Entities*¹ (*FRS for SMEs*), for private entities that meet specified criteria after having considered the feedback received on the Request for Views on *Private Entities, the Way Forward* issued by the Malaysian Accounting Standards Board (the MASB) in February 2012. The *FRS for SMEs* shall be effective for annual periods beginning on or after 1 January 2016.
- 2 The Roadmap summarises the MASB's basis for selecting the *FRS for SMEs*. Prior to this, the MASB had also issued, in addition to ED 72, ED 52 *Private Entity Reporting Standards* as another possible framework to replace the existing Private Entity Reporting Standards (PERS). The MASB had also received comments that ED 74 *Amendments to Financial Reporting Standards arising from Reduced Disclosure Requirements (FRS-RDR)*, which was issued with the intention of reducing the reporting burden of entities that do not have public accountability but are required to apply *Malaysian Financial Reporting Standards (MFRSs)*, may be another alternative to replace the existing PERS.
- 3 This Roadmap has also included suggestions on what the MASB and other stakeholders could do to assist affected private entities in the migration from the existing Private Entity Reporting Standards (PERS) to the *FRS for SMEs* which shall be effective for annual periods beginning on or after 1 January 2016.

Invitation to comment

- 4 The MASB welcomes comments on the questions set out below. Comments are most helpful if they contain a clear rationale and describe any alternative that the MASB should consider, if applicable.

¹ ED 72, which was issued for public comments in 2010, is identical with the *International Financial Reporting Standard for Small and Medium-sized Entities (IFRS for SMEs)* that was issued by the International Accounting Standards Board (IASB) in July 2009.

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5 The MASB is not requesting comments on matters that have not been included in this section. In particular the MASB is not seeking comments on the new framework, the *FRS for SMEs*, because this topic was already subject to public comments during the Request for Views on *Private Entities, the Way Forward* and the exposure of MASB ED 72.

6 The MASB will consider all comments received in writing by **6 May 2013**. In considering the comments, the MASB will base its conclusions on the merits of the arguments for and against each alternative.

7 Questions for respondents:

(a) Question 1 – Differential reporting regime for private entities

The MASB has tentatively decided to require private entities with annual revenue of RM500,000 and above to apply the *FRS for SMEs* for annual periods beginning on or after 1 January 2016. Private entities that do not meet this specified criterion may continue applying the existing PERS.

- (i) Do you agree with the stratification criteria based on the prescribed size threshold of annual revenue of RM500,000 (paragraphs 26–30)? If not, what alternative do you suggest? Please state your rationale.
- (ii) Is the explanation of the scope assessment sufficiently clear to determine when a private entity is required to apply the *FRS for SMEs* (paragraph 29)? If not, what alternative do you suggest? Please state your rationale.
- (iii) Do you agree that a private entity that has applied the *FRS for SMEs* as a result of meeting the specified criterion should be allowed to revert to the PERS if it is eligible to do so? If not, why?

(b) Question 2 – Roles and responsibilities of stakeholders

- (i) Do you believe that the roles and responsibilities of stakeholders in the Roadmap are adequate to assist

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affected private entities in making the transition to the *FRS for SMEs* (paragraphs 36–40)? If not, please provide your rationale in your response.

- (ii) Are there any other stakeholders not mentioned in the Roadmap that should be included? If yes, please state the stakeholder(s) and their roles and responsibilities in the financial reporting framework.

The financial reporting framework for private entities

- 8 The Roadmap sets out a differential reporting framework for private entities. A private entity is a private company², 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.
- 9 The financial reporting framework for private entities uses size threshold based on annual revenue as the differentiator.

Accounting framework	Private entity
<i>FRS for SMEs</i>	Private entities with annual revenue ³ of RM500,000 and above (hereinafter referred to as “medium-sized PE”)

² A private company is defined in Section 15(1) of the Companies Act 1965.

³ Revenue is defined in the *FRS for SMEs* as the gross inflow of economic benefits during the period arising in the course of the ordinary activities of an entity when those inflows result in increases in equity, other than increases relating to contributions from equity participants.

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Accounting framework	Private entity
PERS	Private entities with annual revenue of less than RM500,000 (hereinafter referred to as “micro-sized PE”)

- 10 With this policy decision, there would be three accounting frameworks for application for private entities, namely:

Accounting framework	Eligibility
<i>MFRSs</i> (<i>Malaysian Financial Reporting Standards</i>)	Medium-sized PE Micro-sized PE
<i>FRS for SMEs</i>	Medium-sized PE Micro-sized PE
<i>PERS</i>	Micro-sized PE

The Framework selected shall be applied in its entirety.

The reasons for change

- 11 The MASB is making these changes as it recognises the importance of private entities to the economy.

Importance of SMEs

- 12 National statistics based on the Census Report on Small and Medium Enterprises (SMEs) 2011⁴ indicated that SMEs represent over 97.3% (645,136 businesses) of the total business establishments in Malaysia where they contribute about 32.5% to the nation’s Gross Domestic Product and represents more than half of the work force in the country. Therefore, it is clear that

⁴ Source: Department of Statistics Malaysia 2012

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promoting a viable SME sector is essential in the nation's focus towards broadening the sources of income, employment and sustaining the growth momentum.

- 13 The government launched the SME Masterplan (2012-2020) in July 2012 as part of the New Economic Model. The Masterplan noted that going forward, amidst the uncertain global environment and growing competition, Malaysia requires a 'game changer' to transition the economy to a high income nation by 2020. It noted the role of SMEs will become increasingly critical, not only as enabler of growth by providing the support to large firms but also as a driver of economic growth. The targets set in the SME Masterplan are that SMEs by 2020 ought to increase exports to 25% (2010: 19%), contribute 41% (2010: 32%) of the gross domestic products and increase employment to 62% (2010: 59%).

In order to accelerate performance of SMEs to the next level, the SME Masterplan has identified six performance levers that would drive SME performance. Among them is the ability of SMEs in gaining access to finance.

- 14 Consequently, with the SME Masterplan in mind, i.e. to increase SMEs exports and to improve SMEs' access to finance, the MASB believes it is timely for SMEs to apply the international set of accounting standards for SMEs, that is the *IFRS for SMEs*⁵, which is a simpler (when compared to IFRSs⁶) set of internationally recognised accounting standards designed to suit the needs of SMEs. When the *IFRS for SMEs* was issued in 2009, the World Bank and the International Federation of Accountants (IFAC) in their respective press release said:

“The *IFRS for SMEs* provides a valuable financial reporting reference framework for smaller entities that is more responsive to the size and ownership of their operations, and should help improve their access to finance. In countries that have already adopted IFRS as the national accounting standard, the

⁵ Based on a recent report by the IASB, over 80 jurisdictions have either adopted the *IFRS for SMEs* or stated a plan to adopt it within the next three years (www.ifrs.org).

⁶ International Financial Reporting Standards issued by the IASB.

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simplifications introduced by the SME standard will provide much needed relief.” [World Bank]

“This global accounting standard represents a very significant step on the path to global convergence of financial reporting practices by SMEs. It will contribute to enhancing the quality and comparability of SME financial statements around the world and assists SMEs in gaining access to finance. The beneficiaries will not only be SMEs, but also their customers, clients, and all other users of SME financial statements.” [IFAC]

- 15 SMEs that intend to do business regionally or globally in the future require financial statements that are comparable with other jurisdictions for the following reasons:
- (a) Financial institutions make loans across borders and operate multinationally and they rely on financial statements in making lending decisions and in establishing terms and interest rates.
 - (b) Foreign vendors may want to evaluate the financial health of SMEs before they sell goods or services on credit.
 - (c) SMEs may want to evaluate its overseas supplier’s financial statements to assess the prospects of a viable long-term business relationship.
 - (d) Venture capital firms provide funding to SMEs across borders.
 - (e) Many SMEs have outside investors who are not involved in the day-to-day management of the entity. Global accounting standards for general purpose financial statements and the resulting comparability are especially important when those outside investors are located in a different jurisdiction from the entity and when they have interests in other SMEs.

Users’ and preparers needs

- 16 Besides that, local stakeholders, such as bankers, have expressed their preference for SMEs to apply international accounting standards as they believe such standards would enhance the transparency of the SMEs’ financial position.

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- 17 In addition, the World Bank ROSC⁷ team recommended that the review of PERS be given priority as these standards are outdated. The World Bank Report further recommended that changes to the accounting standards and reporting framework should be based primarily on the needs of the users of the financial statements and public interest considerations.
- 18 The MASB has long acknowledged the need to consider replacing or updating the PERS Framework which in many aspects have not kept pace with the changing business environment as it was developed in 2006 based on 2003-version of certain International Accounting Standards issued by the International Accounting Standards Committee, the predecessor of the IASB. For example, the PERS does not have a standard for financial instruments and it still requires the presentation of “extraordinary items” in the income statement which is not allowed in an IFRS-based framework.
- 19 The *FRS for SMEs* would be closely aligned to the *IFRS for SMEs* and the MASB at this point in time does not intend to make any modifications to align it with the MFRS Framework as recommended by some respondents, for example amend the *FRS for SMEs* to permit revaluation of property, plant and equipment or capitalisation of borrowing costs. The MASB expects most of the medium-sized PE would choose the simpler accounting option and that if a private entity feels strongly about using one or more of the complex options, it could elect to follow full MFRSs, rather than the *FRS for SMEs*. Accordingly, the MASB believes there is no compelling reason to modify the *FRS for SMEs*.
- 20 Furthermore most respondents to the Request for Views were supportive in moving to an IFRS-based framework. They believe adopting an IFRS-based framework, being more dynamic and robust than the PERS, would:
- (a) enable SMEs to leverage on the experiences of other jurisdictions.

⁷ Report on the Observance of Standards and Codes (ROSC) Malaysia, February 2012 (www.worldbank.org/my).

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- (b) better prepare SMEs to transition to the MFRS (= IFRS) Framework when the need arises.
 - (c) minimise the knowledge gap of accountants that apply the PERS and those that apply the MFRS Framework.
- 21 The *FRS for SMEs* is selected over the FRS-RDR for the following reasons:
- (a) the *FRS for SMEs* is a simplified, self-contained set of accounting principles based on full IFRSs which was developed to meet the needs of users of SMEs' financial statements.
 - (b) most of the complex options in IFRSs have been eliminated and disclosures are simplified, for example: not requiring an annual review of residual value, useful life and depreciation method of property, plant and equipment, amortising all indefinite life intangibles, including goodwill, recognising as expenses all research and development costs, recognising as expenses all borrowing costs, all government grants are accounted for using a single simplified model and not requiring the held-for-sale classification.
 - (c) periodic (i.e. once every three years) rather than ongoing updates, like in IFRSs, would maintain a period of calm for private entities and they may not have the internal accounting resources to apply the changes frequently.

The need for differential reporting framework for private entities

- 22 Based on the comments received on the Request for Views, many expressed concerns about the appropriateness of prescribing an IFRS-based framework for all classes of private entities. The MASB took note of the concerns and deliberated at length with various stakeholders whether it is necessary to stratify private entities so as to limit the mandatory application of an IFRS-based framework to larger private entities and allow the smaller ones to apply a simpler set of standards.

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- 23 The MASB, after consideration of the feedback received from its outreach activities, noted the different information needs of users of medium-sized PE and those users of micro-sized PE.

As private entities comprise a varied mix of SMEs, out of which 77%⁸ are micro-sized entities whose users of financial statements are expected to be the owners themselves and external users of its financial statements are likely to be limited, the MASB in this respect believes it is justifiable to introduce differential reporting for private entities.

Secondly, at present, micro-sized PE generally have limited administrative resources and this may hinder their ability to fully cope with an IFRS-based framework.

Therefore, the MASB decided that the reporting framework for private entities should be proportionate to the financial information needs of its users, the availability of resource and the expected benefit derived from preparing IFRS-based financial statements.

- 24 In the light of this policy decision, the private entities are stratified into two categories, i.e. the *FRS for SMEs* would be mandatory for the medium-sized PE, identified by the SME Masterplan to be a key driver of economic growth, while the micro-sized PE at this stage would continue applying the PERS Framework. It is estimated that less than 100,000 entities would need to apply the *FRS for SMEs*.

- 25 The MASB is aware that the IASB staff is developing guidance to help micro-sized entities apply the *IFRS for SMEs*. The IASB staff does not have a fixed timetable for completion but is aiming to publish the guidance in 2013. In this regard the MASB may reconsider its policy decision after reviewing the IASB staff guidance for micro-sized entities. For more information about the IASB staff progress, please visit www.ifrs.org.

⁸ Source: Department of Statistics Malaysia 2012.

The stratification criteria and its application

- 26 On the stratification criteria, the MASB considered whether it should be developed using a principle based approach or quantitative criteria. It decided to use a quantitative criterion based on annual revenue of RM500,000 to distinguish entities that would be required to apply the *FRS for SMEs*. This is because it expects private entities would better understand a stratification criterion based on size threshold given that the National SME Development Council segregates SMEs into micro, small and medium size enterprises based on size threshold, i.e. sales turnover and number of employees.
- 27 While the MASB noted that a principle based definition may be more ideal, however, the use of judgement in a principle based approach may result in complexities for the private entity in determining the applicability of the respective set of accounting framework.
- 28 However, the MASB also acknowledged the disadvantage of stratification based on size threshold as it may involve additional maintenance and monitoring costs. The MASB realised that the size threshold based on revenue would result in private entities of having to keep track whether its annual revenue meet the prescribed criterion, especially for private entities that are at the borderline of the size threshold as any changes in a particular year may result them being within the prescribed criterion or otherwise.
- 29 To address this application issue, a private entity is mandatorily required to apply the *FRS for SMEs* if it meets the prescribed threshold criteria for two consecutive years.

For example, a private entity's annual period beginning on 1 January 20X6 would have to apply the *FRS for SMEs* if its annual revenue exceeded RM500,000 for each annual period of the previous two consecutive annual periods of 31 December 20X4 and 31 December 20X5, regardless of how much its annual revenue for 20X6 would be. If a private entity whose annual revenue for the previous two consecutive years exceeded RM500,000 but below RM500,000 for the current period, likewise, it would have to continue applying the *FRS for SMEs* for the current period – the private entity would only be able to revert

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to the PERS if its annual revenue for each period of the previous two consecutive annual periods was below RM500,000.

- 30 The table below illustrates the mandatory application of the *FRS for SMEs* by a medium-sized PE whose annual financial period ends on 31 December.

Annual period ending 31 December	2014	2015	2016	2017	2018	2019
Annual revenue (RM'000)	510	520	490	480	520	490
Applicable framework	PERS	PERS	<i>FRS for SMEs</i>	<i>FRS for SMEs</i>	Option to apply <i>FRS for SMEs</i> or PERS	<i>FRS for SMEs</i>

Note: All private entities have the option to apply the MFRS but it has been excluded from the above illustration.

Effective date and transition

- 31 The MASB targets to issue the *FRS for SMEs* during the first half of 2013 and it shall be mandatory for medium-sized PE with annual periods beginning on or after 1 January 2016. Early application is permitted.
- 32 The effective date of 1 January 2016, which most respondents to the Request for Views supported, provides a transition period of about three years from the issuance date of the new Framework. Though some would like the new Framework to be implemented earlier, the MASB believes sufficient time should be given to medium-sized PE to attain the required knowledge to implement the *FRS for SMEs* which is an IFRS-based framework. For example, certain areas may be overwhelming especially the accounting concept of fair value measurement and those that require the exercise of professional judgement – the medium-sized PE would have to relook at their current capability to implement and manage the implications of the change. In addition, currently, majority of the accountants are familiar with the current PERS rather than MFRS or *IFRS*.

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- 33 In relation to allowing early adoption, the MASB believes this would enable private entities that prefer to apply an IFRS-based framework the opportunity to do so.
- 34 The MASB is aware that the IASB is undertaking an initial comprehensive review of the *IFRS for SMEs* to enable the IASB to assess the first two years' experience in implementing the Standard and consider whether there is a need for any amendments. The MASB does not believe the IASB's comprehensive review should delay the issuance of the *FRS for SMEs* but it would consider any amendments proposed to the *IFRS for SMEs* and would consult on those proposed amendments when issued by the IASB. Based on the IASB's work plan as at 4 February 2013 the Exposure Draft would be issued during the first half of 2013 and the revised *IFRS for SMEs* would be issued during the second half of 2013 or the first half of 2014, to be effective in 2015.

Challenges during the transition and implementation period

- 35 Certain areas of the *FRS for SMEs* may be overwhelming and may impose challenges to the stakeholders in the financial reporting chain. These challenges include:

(a) Resource and capabilities

Stakeholders in the reporting chain may have to allocate additional resources as compared to prior years to ensure a smooth transition to *FRS for SMEs*. The medium-sized PE would have to prepare itself during the transition period to mitigate the risk of errors in financial statements as a result of applying the new Framework. Nevertheless this would depend on whether the medium-sized PE undertakes complex transactions. If so, it is expected that the costs to the entity would rise during the transition and in the first year of adoption. For medium-sized PE that do not undertake complex transactions it is expected minimal costs would be incurred, mainly in revising the format of their financial statements.

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(b) Training and education

Most private entities have been applying the PERS since its introduction in 2006. Consequently, a change to the *FRS for SMEs* which is IFRS-based may further compound the challenges in the implementation process if they have not kept themselves abreast with development and changes to IFRSs. Therefore, a systematic training and education plan during the transition period is important.

Apart from preparers of financial statements and the auditors, academia would need time to learn and teach the new Framework to students. So do other stakeholders, such as the regulators, analysts and other interested parties, who may also need time to learn and understand *FRS for SMEs*.

Hence, training and education costs are expected to increase as a result of implementing the *FRS for SMEs*. However, if stakeholders alike are already providing training and education in IFRSs and an IFRS-based framework is implemented, these costs are expected to be minimal.

(c) Business processes and financial reporting systems

Data collection processes and key supporting systems in an entity may need to be configured to comply with the new Framework. Hence, data collection processes and key supporting systems that are changed so as to comply with the new Framework may affect other aspects of an entity's operations.

Additional time and costs may have to be incurred to understand the changes from the previous Framework to the new Framework. For example, procedures such as the audit work programme may have to be revisited given the changes in the accounting standards.

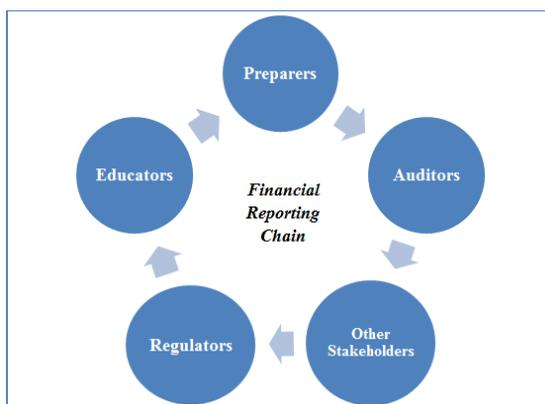
Roles and responsibilities of stakeholders

- 36 In order to tackle these challenges, the MASB proposes several specific action plans for stakeholders in the financial reporting chain to ensure a smooth implementation of the *FRS for SMEs*. These stakeholders consist of the preparers, educators, auditors,

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regulators and all other interested parties such as users of financial statements.

- 37 A broad range of key stakeholders concerned have been consulted throughout 2006 and 2012, including regulators, government agencies (i.e. SME Corporation), users, preparers, professional bodies, academia, auditors and accountants. The consultations were conducted through public forums and circularisation of questionnaires and surveys.
- 38 In order to make the transition to *FRS for SMEs* a success, all stakeholders in the financial reporting chain (see diagram below) must play their role.



- 39 Append below are some pertinent roles and actions required during the transition period by the MASB and some of the stakeholders in helping private entities to migrate to the *FRS for SMEs*:

(a) MASB

Based on the feedback received from the Request for Views, private entities would require a longer lead time to learn and plan for the transition processes. For this reason, the MASB targets to issue the *FRS for SMEs* by the first half of 2013 so that private entities are given at least more than a year from the date of transition of 1 January 2015 to plan for the transition process.

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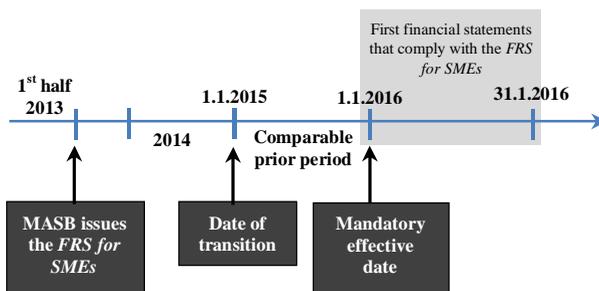
A task force comprising of regulators, government agencies, professional bodies and educators may be set up to coordinate efforts of relevant authorities in reviewing the SMEs' progress and transition to the new Framework.

The MASB would also continue to monitor closely development of the IASB's comprehensive review of the *IFRS for SMEs* and the IASB staff guidance for micro-sized entities and assess its impact to the MASB's policy decision.

(b) Preparers

Although the mandatory effective date of the *FRS for SMEs* is 1 January 2016, the new requirements are also applicable to the previous comparative period. Therefore the management of the medium-sized PE would have to commence the impact assessment of the *FRS for SMEs* at the date of transition. The date of transition is defined as the beginning of the earliest period for which an entity presents full comparative information in its first financial statements that comply with the *FRS for SMEs*.

For example, if the *FRS for SMEs* is adopted for annual periods beginning on 1 January 2016, the date of transition would be 1 January 2015.



Therefore, in this example, management and accounting staff of the medium-sized PE would have to start learning about the *FRS for SMEs* in 2014 so that they would have the knowledge to perform a gap analysis to identify what system or process changes that are needed so as to capture the required information as at 1 January 2015 being the date

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of transition. Management should be prepared to invest in their human resources and systems infrastructure and establish an appropriate implementation plan to ensure a smooth transition to the new Framework.

(c) Professional bodies

Professional bodies would have to review and include the *FRS for SMEs* into its training program to educate its members. It could also consider:

- (i) developing accounting manuals to assist members in learning the *FRS for SMEs*.
- (ii) setting up help desk to respond to technical enquiries regarding the new Framework.
- (iii) creating awareness among its members regarding the new Framework by periodically publishing articles or sending out email alerts.

(d) Educators (Universities and colleges)

The role of educators is critical as they have been tasked to prepare our future graduates to be relevant in the work place. Since SMEs represent over 97.3% of the total business establishments in Malaysia, the demand for accounting graduates by the SME sector is expected to be higher than listed companies of the capital market which have to prepare its financial statements using the MFRS. Therefore it is important that the universities' syllabus incorporate the *FRS for SMEs* as a mandatory subject to equip students with the relevant knowledge so that they would be ready for the roll-out of the new Framework when they join the market place.

Coincidentally the universities' syllabuses are being updated in line with the objectives of the Malaysia Education Blueprint 2013-2025 and the Hala Tuju 3 initiative by the Ministry of Higher Education (MOHE). This, the MASB believes, presents a good opportunity for academia to propose to the MOHE empowering the universities to update its accounting syllabus as and when there is a development at the MASB. This would enable the

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universities to teach students updated accounting requirements so that the knowledge they acquire are relevant when they join the market place.

(e) Auditors

Auditors should create awareness among its clients and encourage them to prepare early for the new Framework. Auditors should also train the audit staff on the *FRS for SMEs* requirements early and review and revise its audit work programmes to cater to the new Framework.

(f) Regulators

Regulators involved in surveillance may need to consider whether it is necessary to review its rules and regulations. To do so, regulators may also have to learn about the *FRS for SMEs* requirements so as to be equipped to carry out its compliance review effectively. The MASB would appreciate if regulators could assist to create awareness of the new Framework.

40 Appendix 1 provides a summary of the milestones during the transitional period to the *FRS for SMEs*.

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Appendix 1

Milestones during the transitional period to the *FRS for SMEs*

