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by fax, email & post

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Dear Sir,

COMMENT ON EXPOSURE DRAFT 52 – PRIVATE ENTITY REPORTING STANDARDS(PERS)

I appreciate the opportunity to present my comment for consideration by MASB. I would like to congratulate MASB for taking the initiative to issue this exposure draft consisting of 170 pages and complete with an illustrative financial statements. It certainly looks impressive.

There has been a view for some time that smaller companies should have difference accounting because of different users needs and also on the basis of cost benefit consideration. MASB has in fact already recognized such need when it issued MASB SOP 1 Exempt Enterprise. With more and more complex new and revised financial reporting standards being issued, such view expectedly grew stronger. I think the general view is that there could be a valid reason why smaller private companies should have a different accounting treatment. However it should be noted that having a different set of accounting for such companies can also create other problems. As such, whether there should be a difference accounting and in what form the difference should be require a very thorough and careful study with input from all relevant parties and after going through the necessary due process. This should partly explain why IASB has yet to issue an exposure draft until today after 2 years of issuing a Preliminary View on Accounting Standards For Small and Medium-sized Entities. Some jurisdiction such as U.K. and Hong Kong has gone ahead to issue the national version of standards for SMEs/PEs.

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There is no doubt that MASB needs to consider the need of having some form of difference accounting for SMEs. The creation of PERS by MASB is clearly for this objective. My concern is on the process, timing, scope, approach and format of the PERS.

I believe MASB has addressed all these concern diligently. But without issuing Basis of Conclusion, it is impossible for the public like me to know the answer.

As mentioned, this exposure draft does not come with Basis of Conclusion. Also there is no Comparison With FRSs or Summary of Differences between PERS and FRS. This makes the job to give comment very difficult. My comment therefore may partly consist of questions instead. Also, I am concerned that MASB may not receive sufficient valuable and quality comments because of the absence of the above 2 documents. I feel it is important for MASB to engage closely with the interested parties before any final standard is issued to ensure all issues have been properly and adequately addressed.

Nevertheless, I am pleased to set out in the attached Appendix my comment to this Exposure Draft for consideration by MASB.

I wish to highlight that my comment is based on my selective review of the Exposure Draft. It is almost impossible for an individual with limited resources and other priority like myself to do a complete review. Had I done a complete review, some of my comment may be altered and more comment may be given. However, I am hopeful that my comment will be useful to MASB.

Yours truly,

Goh Kean Hoe
Managing Proprietor

Encl.

**GOH KEAN HOE
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COMMENT ON EXPOSURE DRAFT 52 – PRIVATE ENTITY REPORTING
STANDARDS(PERS)**

Comment on Question 1 :

I thought this question is no longer relevant as MASB has already decided to have a separate set of reporting standards when it announced the 2 sets of standards in February 2006 and set out the scope of PERS by introducing and defining Private Entity. That announcement was though a big surprise as

- a) contrary to the normal due process any accounting standard setting body is required to adhere to before it issues any standard, there was no invitation to public for comment before the decision was made. The transparency of how the decision was made was also absence. Which board member agreed and which disagreed? Who has been privately or officially consulted? What study has been undertaken to justify the need ? Non issuance of Basis of Conclusion make it extremely difficult to give comment on this important decision of having a different set of reporting standards for SMES.

- b) IASB has a project for SME standards but there is still no exposure draft after a few years. FASB has just issued a paper to invite comments on the structure of a proposed committee to study the need to have difference accounting for private companies. Of course some countries like UK and Hong Kong have issued their own version of standards for SME/PE. Out of sudden, MASB issued a separate standard for private entities as defined. The question is have we conducted enough study and research. Have we had enough dialogue with the interested parties such as the users group? I do not mean we must necessarily follow or wait for IASB to issue it before we could do it. We can always be ahead of IASB but it must be after sufficient study and consultation as this difference accounting has far reaching implication to the business, accounting profession and education sector. There are many pros and cons of having a different set of standard and they must be studied very carefully.

Although I agree to give due consideration to have a difference accounting for SMEs on the basis of different users need and more importantly the cost benefit factor, I also like to highlight that creating another set of standards can also create other problems. One argument against having a separate set of standards for SMES is that all transactions with similar economic and substance should be treated the same way accounting wise irrespective of the ownership structure and size of company. To have a difference

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accounting will create the issue of comparability. The trend is towards having same accounting standards and not different accounting standards. By giving option to PEs to either follow PERS or FRS may make things worst as it could result in 2 private companies in the same business using different accounting standards – so how to compare?

We also need to bear in mind that all accounting standards apply to material transaction only. Also non compliance of one standard or a requirement of one standard does not mean the financial statements are wrong or useless. So another way of dealing with private companies is if at all it is too costly to follow certain standard or certain requirements– just do not follow it – disclose it and auditors may qualify the report – users will get to know and if there is a need, the user can request for it directly from the company. This of course should ideally be avoided.

In addition, a lot of complicated standards may not apply to private companies anyway. If it applies, chances are the company is relatively big and the question of cost may therefore be less relevant.

From education point of view, having a separate standards for SME or PE can be confusing and complicated. It is discouraging accountants and small practitioners to update their FRS knowledge.

Have MASB considered the above points?

I personally think that given limited resources, our priority should be training our accountants and preparing our corporate and business sectors to be ready to adopt IFRS in full unlike the present situation where we do not adopt some of them or adopt later. For instance no date has been set for FRS139 yet while other countries have adopted it since 2005. Our priority should be to be on par as IFRS as soon as possible and put our country in the map of those with full convergence to IFRS.

As stated, IASB is actively developing the standards for SME. We should wait for that. Otherwise, when that is issued, we may have to change our standards again. This will cause confusion and result in inefficiency and duplication of effort.

I believe and I hope MASB has already considered all the relevant factors including those mentioned above before it decided to issue PERS. What is required now is to develop a high quality PERS.

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Comment on Question 2 :

I am of the view that this statement is worryingly incorrect.

Firstly, if PERS provides high quality financial information then what about FRS?

Secondly 'proprietary needs' require explanation. Further in the salient points provided by MASB in its website, it stated as follows:

'However, the Framework for PERS focuses on information needs by owners, who are also managers of the private entities to be the most significant users

I think to say that 'owners are also managers' is totally wrong as it is common that there are shareholders who are not in the board of directors or in the management team. A private company can have 10 or 20 shareholders and not all will be in the board. Also, assuming that all owners are managers then they will have no problem to have access to the financial information required. In other words, their needs are already addressed. I agreed that those other users mentioned are able to obtain the information they need by way of request except for employee and customers groups as the private companies may not feel the need to entertain their request. The only source of financial information for these groups are therefore the general purpose financial statements prepared in accordance with the law ie the Companies Act 1965 in the case of Malaysia.(the exception is that private exempt companies that are solvent may choose not to lodge annual financial statements with SSM)

Comment on Question 3 :

Firstly the talk in the industry has been having a separate standards for SMEs ie smaller companies. IASB project is also on SMEs although it leaves it to the individual jurisdiction to decide the scope. It is hence a surprise that this PERS totally ignore the question of size. Again because there is no Basis of Conclusion provided, the reason for it is not known. This means a private company with RM100 million turnover or assets or one with 500 employees are not required to follow FRSs. Is the cost of complying with FRS a big concern of the company of this size? Why are they given the option to use PERS?

On the other hand, why should a company running charitable programme which is small, say with assets of less than RM100,000 to spend the extra money(the assumption is it is costly to apply FRS) to follow FRS instead of spending the money for charity? If the argument is that there should not be any complicated FRS to be followed if the company is so small then why need PERS for other small commercial companies? I understand that more importance should be placed on public accountability than cost but it is really a matter of relative. Is the extra saving from applying a simplified accounting standards that can be used for charity purpose more than off set the possible loss that may be

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suffered by applying a supposedly lower level of accounting standards in preparing the financial statements of the charitable organization?

Lastly, the definition of Public Accountability is very vague. How high is considered 'high degree of outside interest What is the definition of 'interest' here?

In my opinion if at all there is a need to have a separate financial reporting standards for a different group of companies it should be the smaller private companies. Of course there is a need to define small. Again no reason is available as to why the concept and definition of 'Exempt Enterprise' as contained in MASB SOP 1 is totally abandoned. For instance, currently Exempt Enterprise can choose not to follow FRS111 ie using percentage of completion method to account for the construction contracts. However under PERS, a small sub-contractor with a contract worth RM50,000 that last for 4 months will also have to apply percentage of completion method. Are we making it easier or more difficult for SMEs?

In short I think both public accountability and size needs to be considered in setting out the scope. I understand the difficulty of setting the right size as it is highly judgmental but that should not be the valid reason for not considering it.

Comment on Question 4 :

There should be no hurry to implement this as the Private Entities have already been shielded from the new and revised FRS effective 2006 which are supposedly more complicated. In addition and as mentioned, IASB is expected to issue its exposure draft for SME accounting soon. Otherwise there might be too many changes in a short period creating more problems and confusion. MASB can then have more time to carry out more study and research in the light of the comments received and the new development so that the final output will be of high quality as well as achieving the objective.

Comment on Question 5 :

I wonder how 2 different sets of financial reporting standards can be developed based on same framework? Isn't it inconsistent? Then there can be 3 or 4 sets. There has to be a different and that different must be addressed and highlighted. The Framework can be borrowed but modification must be made where necessary.

Comment on Question 6 :

It is not necessary to make it that only cost basis can be used. Wherever possible, FRS should be followed. For instance, FRS116 allowed either cost or revaluation model. There should be no problem to adopt this as the private entities who think it is not cost beneficial to use revaluation model will not use it anyway or can choose not to use it.

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What is the rationale to restrict it to cost and then at the same time allow FRS116 to be adopted if one desires(optional reversion). It is unnecessarily complicated and confusing.

Comment on Question 7 :

I do not fully agree with the approach and format used.

This PERS with the Appendices consist of about 160 pages organized by chapters. It really is a book. I did not read all the pages. However my quick review shows that it is nothing more than a summarized version of all the relevant FRSs adopted for PERS with a few exclusion in certain standards.

As expected, fundamental accounting treatment such as revenue recognition, provisions, income taxes, inventories, construction contracts, events after balance sheet date etc have to be the same under FRS and PERS as similar transactions should be accounted for similarly irrespective of the ownership structure of companies. What this PERS does is simply copying from the relevant FRS word for word but leave out those paragraphs which are of further expansionary and illustration in nature. Obviously the objective is to make the PERS not so thick. But the question is if users of FRS who supposedly have better technical knowledge need to read those expansionary and illustration paragraphs and appendices (if any) in order to understand the standards fully and correctly, what makes MASB think that users of PERS would be able to understand and apply the standards without those paragraphs and appendices? Assuming the users of PERS care or happen to find out that the related FRS provides more guidance(for instance, to find out what is Depreciable Amount and Residual Value) and decide to make use of it, isn't it back to square one ie the relevant FRS will still be or need to be used by user of PERS in order to have a better understanding of the standards. That being the case, why not PERS just refer to the relevant FRS. The interesting thing is this approach of referring to the relevant FRS is used for cash flow statement, business combination, consolidation, investment in associated company, joint venture, share-based payments etc. So inconsistent approach is being used. It is also noted that the accounting standard for property development is surprisingly not included in the main content without any reason given. This is despite the fact that there are so many small and medium property developers who are PE.

The bigger problem of this approach is one has to read and compare with FRS in details to find out whether there is any difference and what are the differences. Surely users will need to make their own notes of the differences unless somebody write a book on the differences. Inevitably, many will get confused between FRS and PERS.

Based on the above, it makes a lot of sense to use the approach based on the differences ie the PERS should only document the exception, restriction and modification granted to PEs. Not only will this make the PERS book very much thinner, it will also make it easy to understand and less confusing. This will also avoid complication in the

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education/academic sector as FRS will clearly be the official text. After all we are talking about difference accounting for SMEs so the approach should be by way of differences.

For instance, in respect of those FRSs where certain exception is given or restriction is imposed such as property, plant and equipment is not allowed to be stated at revalued model, all that PERS needs to do is to make reference to FRS 16 with the stated exception or/and restriction as applicable. This is one possible approach.

As an alternative, the current format may be retained but a separate session should be inserted at the end of each topic to set out a comparison to the corresponding FRS. It may look like below.

Applicability of FRS116

Except for the differences and/or modifications described below, applying FRS116 will conform with the requirements on the accounting and financial reporting for property, plant and equipment as discussed in this topic and vice versa.

Differences and modifications from FRS116:

a) Subsequent Measurement – Revalued Model

Under FRS116,

b)

Accordingly, more guidance on and clarification of the requirements included in this topic may be obtained by referring to the said FRS.

Comment on Question 8 :

What if there is no FRS? Can reference be made to IFRS?

Comment on Question 9 :

What about the situation where a PE might have downsized its operations to the extent that it is now felt that it is no longer cost beneficial to follow FRS?

Changing back to PERS should be allowed and may be accounted for as change in accounting policies. The reason is both set of standards are considered acceptable.

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Comment on Question 10 :

Such option will make the comparability of financial statements among PEs and with Non PEs and with foreign companies even more difficult. It will become 'rojak'. PEs may be encouraged to evaluate which treatment suits it objective more. This is unnecessary and can be confusing.

The approach should be to keep the difference minimum. For instance and as mentioned above, the revaluation model for PPE should be allowed under PERS as FRS116 because it is an option anyway.

Comment on Question 11 & 12 :

Firstly change of accounting policy and errors are not common events. Secondly the relevant FRSs already allow the restatement of the comparative figures to be exempted if it is impractical to quantify. Thirdly in most cases quantifying the effect into last 2 years are not difficult once the cumulative effect has been determined. As such since this PERS requires cumulative effect to be done, it is not necessary just to stop there. We should not be difference for the sake of difference. As stated before, the difference should be kept minimum.

Comment on Question 13 :

There should be only one concept and principle of deferred tax to avoid confusion. In addition both concepts would usually result in same amount of deferred tax except for certain events and transactions which are not common among smaller PEs. If deferred tax is not material, it may not be accounted for. On the other hand, if the deferred tax is material and if it is not accounted for, the effective tax rate will be significantly difference from the statutory tax rate. There will be problem to reconcile the two and to explain for it. The answer is clear ie account for deferred tax if it is material. Ignore it if it is not material.

Comment on Question 14 :

The statement that cash flow statement does not add benefit to users only shows that the person who made the statement do not understand and appreciate cash flow statement. As we all know cash is very important to every business. Where else can a user understand the cash flow position of the company if not through cash flow statement ?

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Comment on Question 15 :

Any additional disclosures should be encouraged. As such it should be made optional. The disclosure of financial risk sometime forces the owners to think through it and take the necessary action if he/she feels necessary for the interest of the company. This is in fact one possible side benefit of following the rigorous requirements of FRS as many of the new requirements can result in better management of assets and risk management. Another example is the impairment test. However consideration should be given to allow the option of using market value only as recoverable amount instead of the higher of market value and value in use. In this way, there will be no need to determine value in use (which involve use of discounted cash flow method) when market value is lower than carrying amount.

Comment on Question 16 :

I agree to allow exception to the requirement for consolidated financial statements in certain situation but not by leaving it to the shareholders to decide. I will suggest that MASB consider situations as described in para 5 (4) (a) and (b) of the 9th Schedule of the Companies Act 1965 as possible situations where exception can be granted. A clearer guidance may need to be developed. In respect of investment in associated company and joint venture, equity accounting should only required if a consolidated financial statement is prepared ie as status quo.

Comment on Question 17 :

I agree to do this as a temporary measure. But moving forward, it should be adopted when the preparers and users are ready to use functional currency as there should not be 2 methods of currency definition and reporting.

Comment on Question 18(any other comment) :

Share-based payment:

Accounting for share-based payment can be made optional for SMEs. The rationale is this is a very new and controversial accounting concept and requirements with no real cost involved. However disclosure of the existence of share-based payment/transactions should be required so that the users can better understand the overall financial situation of the company.

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Related party disclosures:

Disclosure requirement for key management compensation should be reviewed.
Disclosure requirement for transactions with shareholders who are individuals and their related parties should be considered as this can be common and it helps to understand the financial situation better.

Income Statement:

The 2 options of analyzing the expenses either by nature or function should be allowed. MASB should not assume PEs will have problem to use functional method. In any case it is only an option like FRS.

Illustrative Financial Statements:

Generally further improvement is required.

The Working Group:

I think such a big project would require a bigger team consisting of capable representative from relevant parties, user groups and stakeholders. It is noted there is no enough representative from small and medium practitioners, accounting professional bodies, chambers of commerce and employee organizations.

Others:

As mentioned above, there should be more dialogue, transparency, due process and there should be issuance of Basis of Conclusion and Summary of Differences and Board members voting result for consumption by the public and to assist getting more meaningful feedback and comment in an efficient and effective manner.

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Next Step:

I suggest MASB consider the following as next step:

- a) do a thorough review on the scope of PE/SME taking into consideration both nature of ownership and size
- b) identify specific recognition, measurement(initial and subsequent), disclosure and presentation requirements of existing FRSs where it is burdensome or costly to follow. Lack of technical knowledge or expertise can not be a valid reason as external help can be seek These identified areas will serve as the potential exception or modification for SME/PE provided it will not cause the financial statements to be misleading or not reflecting the true financial position and performance of the entity.
- c) re-examine the approach used to document the separate set of standards of SME/PE or improve and enhance the current format
- d) engage active dialogue with all relevant and interested parties and enlarge and enhance the Working Group to ensure all useful views and opinions are obtained
- e) consider issuing a revised exposure draft after considering the comments received and the exposure draft of IASB(if available) in the near future with Basis of Conclusion and Comparison With FRSs to make it easy for public comment.